fighting costs, and repairs to public facilities and utilities as a result of flood losses. Whenever these costs are not specifically charged to flood plain occupants, they are a proper NED benefit of plans which remove activities from flood plains.

§ 343.8 NED costs.

The principle is that the NED costs are those which reflect fair market values. Therefore, increased acquisition costs due to Pub. L. 91–646, Uniform Relocation Assistance and Real Property Policy Act of 1970, will be treated as financial costs only and will be assumed to at least equal the social benefits thus derived. The BCR will exclude such costs and benefits. In the case of physical relocation of structures, a benefit equal to the market value of the relocation sites with the relocated structures should be claimed. In the case of evacuation, a cost offset equal to the market value of salvageable material should be claimed. In estimating annual O&M costs when a specific with project land use is planned, the repair of flood damages to any facilities to be placed on the flood plain must be included as a project cost. Also the costs of cleanup of debris deposited by floods should be included if appropriate to the with-project use of the flood plain.

§ 343.9 Presentations.

Illustrative presentation formats are shown in Appendix A.

Appendix A—Illustrative Presentation Format

Accounting for NED Benefits and Costs of Permanent Evaluation and Relocation Measures Which Reduce Flood Damages

Example I: *Plan Which Permanently Evacuates Current Uses From Flood Plain and Converts Flood Plain to New Use But Does Not Physically Relocate Structures to Flood-Free Sites*

NED costs

First Costs.—Acquisition of Lands and Structures in Flood Plain at Fair Market Value (Exclude Pub. L. 91–646 Costs from Economic Costs)

Removal of Structures from Flood Plain (Net of Market Value of Salvageable Items)

Conversion of Vacated Flood Plains to New Use

Contingencies

Engineering, Supervision and Administration

Annual Costs—Interest and Amortization of First Costs Operations and Maintenance Associated with New Use

NED benefits

Annual Benefits.—Reduction of Externalized Flood Damages, e.g., Reduction of Insurable Flood Damages, Reduction of Emergency Evacuation Costs and Other Emergency Costs, Reduction of Flood Damages to Utility, Transportation and Communication Systems, and Other Public Savings (e.g., Savings in Insurance Company Administration Costs)

Benefits from Flood Plain's New Use, e.g., Value of Recreation Visitor Day

Other, e.g., Locational advantage Accruing to Off-Flood Plain Properties Adjacent to Open Space

Example II: *Plan Which Permanently Evacuates Current Uses From Flood Plain, Converts Flood Plain to New Use and Relocates Structures to Flood-Free Sites*

NED costs

First Costs.—Acquisition of Lands and Structures in Flood Plain at Fair Market Value (Exclude Pub. L. 91–646 Costs from Economic Costs)

Acquisition of Lands for Relocation Sites

Preparation of Relocation Sites

Transfer of Structures to Relocation Sites

Conversion of Vacated Flood Plain Lands to New Use

Contingencies

Engineering, Supervision and Administration

Annual Costs.—Interest and Amortization of First Costs, Operations and Maintenance Associated with New Use (If Applicable)

NED benefits

Annual Benefits.—Reduction of Externalized Flood Damages, e.g., Reduction of Insurable Flood Damages, Reduction of Emergency Evacuation Costs and Other Emergency Costs, Reduction of Flood Damages to Utility, Transportation and Communication Systems, and Other Public Savings (e.g., Savings in Insurance Company Administration Costs)

Annualized Market Value of Relocation Sites with Structures

Benefits from Flood Plains in New Use, e.g., Annualized Market Value of Urban Renewal Lands for Uses Compatible with Flood Hazard

Other, e.g., Locational Advantage Accruing to Off-Flood Plain Properties Adjacent to Open Space

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federal register

Wednesday
April 4, 1979

Part IV

Securities and Exchange Commission

Improving Government Regulations; Agenda

SECURITIES AND EXCHANGE COMMISSION

Agenda of Certain Regulatory Matters

AGENCY: Securities and Exchange Commission.

ACTION: Publication of Commission Agenda.

SUMMARY: The Securities and Exchange Commission has determined to publish a listing of anticipated major rulemaking and related regulatory matters likely to be considered by the Commission during the balance of 1979.

FOR FURTHER INFORMATION CONTACT: Christine Delaney, Office of the Secretary, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, (202) 755–1160.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission has traditionally been sensitive to the need to broaden public participation in the Commission's regulatory processes and to promote public understanding of the Commission's work. Consistent with that policy, the Commission has determined to publish the following agenda of anticipated major rulemaking and related regulatory matters likely to be considered by the Commission during the balance of 1979.*

This agenda is based upon Commission priorities at the time of publication. Because the Commission must respond to developments in the capital markets, changes in economic conditions, new Congressional priorities and similar circumstances not readily predictable, this agenda is not necessarily definitive. Additionally, this agenda does not include matters which, although under consideration, have not yet evolved to a point in the deliberative process where public Commission action may be anticipated. Accordingly, while the Commission believes that the information set forth herein should be of substantial benefit to those with an interest in the Commission's work, persons affected by Commission action should not rely solely upon this agenda for guidance.

* * * * *

* In that regard, Chairman Williams, in a letter dated January 9, 1979, to Douglas M. Costle, Chairman of the U.S. Regulatory Council, stated that the Commission was presently preparing a regulatory agenda and that a copy would be provided to the Regulatory Council. A copy of that letter, along with an accompanying memorandum detailing the Commission's recent efforts to implement regulatory reforms is on file under the title "Commission Regulatory Reform Initiatives," and available for public inspection at the Commission's Public Reference Room, 1100 L Street, N.W., Washington, D.C. 20549.

A. Significant Initiatives in the Areas of Capital Formation and Corporate Disclosure

1. *Tender Offer Rule Proposals.* The Commission has recently proposed rules which would provide specific filing and disclosure requirements, and additional substantive regulatory protection for public investors with respect to certain cash tender offers and exchange tender offers. In addition, these proposals embody antifraud provisions which would apply to all tender offers. The Commission intends to consider the proposed rules as soon as possible following completion of the staff's analysis of the public comments. The public comment period expires March 30, 1979. For further information, see Securities Act Release No. 6022. (February 5, 1979) (44 FR 9956).

2. *Proposed Rules Concerning Activities of Public Companies Which Seek to Become Private Corporations.* The staff of the Commission is presently studying certain rule proposals, on which public comment was solicited during 1977, with respect to "going private" transactions. These proposals would create disclosure requirements and other substantive regulations where such transactions involve tender offers, and possible antifraud regulations based, in part, upon the fairness of the transactions to public shareholders. The Commission will consider whether to adopt the proposed rules upon the completion of the staff's study. For further information, see Securities Exchange Act Release No. 14185 (November 17, 1977) (42 FR 60090).

3. *Small Business Capital Formation.* The Commission has recently concluded a series of public hearings, held at various locations throughout the country, which were designed to examine the effects of the Commission's rules and regulations on the ability of small businesses to raise capital. Several important initiatives have already been implemented by the Commission, and the staff is presently studying additional proposals which include simplified registration forms for small issues of securities and the easing of certain restrictions under Regulation A. The Commission will, over the next several months, consider these and other proposals resulting from the staff's comprehensive analysis of the views expressed at the public hearings. For further information, see Securities Exchange Act Release Nos. 14529 and 14530 (March 6, 1978) (43 FR 10876 and 10888).

4. *Corporate Governance.* In April 1977, the Commission announced a comprehensive study of the difficult issues relating to corporate governance and corporate accountability. During 1978, the Commission conducted hearings in four cities concerning ways in which corporate accountability could be strengthened and shareholder participation in corporate governance could be enhanced. The Commission subsequently proposed, and recently adopted in modified form, rules to expand and supplement disclosures made to shareholders in proxy statements. These rules are intended to provide investors with enhanced information on the structure, composition and function of corporate boards of directors.

The Commission anticipates that a staff report on corporate governance issues will be completed prior to the close of 1979. Following publication of this report, the Commission will consider what further action, if any, is appropriate. For further information, see Securities Exchange Act Release No. 15384 (December 6, 1978) (43 FR 58522).

5. *Projections.* The Commission has proposed for public comment a rule which would provide a "safe-harbor" from liability under the Federal securities laws for certain management projections of revenues, income and earnings per share. The Commission will consider the proposed rule after the staff has completed its review of the public comments. For further information, see Securities Act Release No. 5993 (November 7, 1978) (43 FR 53251).

6. *Form 10–K.* In its report to the Commission in November 1977, the Advisory Committee on Corporate Disclosure recommended revisions to the present annual report file pursuant to the Securities Exchange Act on Form 10–K. The Commission subsequently published a release requesting comments on Form 10–K and on the proposed revised format recommended by the Advisory Committee. The Commission will consider appropriate revisions to the Form after the staff has reviewed the public comments. For further information, see Securities Exchange Act Release No. 15068 (August 16, 1978) (43 FR 37460).

B. Significant Initiatives Affecting Regulation of the Securities Markets and the Securities Industry

1. *Rule 15c3–1.* The staff is presently studying the possibility of proposing amendments to Rule 15c3–1 under the Securities Exchange Act, the "net-capital rule," and expects to make recommendations for revisions to the Commission during 1979.

2. *National Market System.* In furtherance of its Congressional

mandate to facilitate the establishment of a national market system for securities, the Commission has recently issued a status report assessing the progress made toward this goal during 1978 and setting forth the Commission's views as to those steps which must be pursued during 1979 to comply with this statutory directive. The Commission may also consider other national market system initiatives, such as revisions to rules dealing with the transaction reporting system, quotation information and guidelines for designating securities as qualified for trading in the national market system.

3. *Proposed Rule 13e–4 and Schedule 13E–4.* The Commission will consider, at the conclusion of the staff review of the public comments, whether to adopt a revised version of proposed Rule 13e–4 and related Schedule 13E–4 under the Securities Exchange Act, dealing with tender and exchange offers by issuers for their own equity securities. The proposed rule would require certain issuers and closed-end investment companies to comply with substantive and disclosure rules which, in part, follow those currently required only in connection with tender and exchange offers by persons other than issuers. For further information, see Securities Exchange Act Release No. 14234 (December 14, 1977) (42 FR 63066).

4. *Proposed Rule 13e–2.* The Commission may consider whether to publish for comment a revised version of proposed Rule 13e–2, previously published for comment in 1970 and 1973, which would impose restrictions on issuers repurchasing their own securities in open market transactions.

5. *Proposed Rule 10b–21.* The Commission may consider whether to adopt or republish for comment proposed Rule 10b–21 under the Securities Exchange Act, which would regulate shortselling prior to underwritten offerings. For further information, see Securities Exchange Act Release No. 13092 (December 21, 1976) (41 FR 56542).

6. *Registration Standard for the Regulation of Clearing Agencies.* The Commission may consider the establishment of a permanent registration standard for the regulation of clearing agencies. This standard would specify criteria which the Commission will use to measure clearing agency rules against the statutory standards for registration.

7. *Proposed Rule 17Ad–8.* The Commission may publish for comment a revised version of proposed Rule 17Ad–8 under the Securities Exchange Act. The rule would codify the existing depository practice of transmitting to an issuer, at the issuer's request and upon payment of a reasonable fee to the depository, a listing of persons on whose behalf the depository holds that issuer's securities. For further information, see Securities Exchange Act Release No. 14493 (February 22, 1978) (43 FR 8269).

8. *Rule 19b–4.* The staff is presently working on a proposal to amend Rule 19b–4 under the Securities Exchange Act, in an effort to enhance the efficiency of the Commission's oversight of self-regulatory organizations. This rule specifies the procedures that self-regulatory organizations must follow in filing proposed rule changes with the Commission.

9. *Rules 10b–10 and 15c2–12.* The staff is presently reviewing public comments received concerning proposed amendments to Rules 10b–10 and 15c2–12 under the Securities Exchange Act. These amendments would require brokers, dealers and municipal securities dealers to disclose on customer confirmations the amount of remuneration received by the broker, dealer or municipal securities dealer in certain transactions in debt securities. For further information, see Securities Exchange Act Release Nos. 15219 and 15220 (October 6, 1978) (43 FR 47495 and 47538).

10. *Proposed Rule 3a4–1.* The Commission may consider whether to repropose for comment proposed Rule 3a4–1, which is an interpretative rule providing guidance to companies issuing securities as to the circumstances under which the company's own officers and employees would be brokers under the Securities Exchange Act if they participated in the sale of the company's securities.

11. *Rule 15b9–2.* The Commission may consider a proposal to amend Rule 15b9–2 under the Securities Exchange Act, to require SECO firms to pay their annual assessments to the Commission on or before the 1st of September each year, in order to coordinate the payment of these assessments with the close of the Commission's fiscal year, on the 30th of September.

12. *Rule 15b10–12.* The Commission may consider a proposal to amend Rule 15b10–12 under the Securities Exchange Act, which specifies those rules not applicable to municipal securities brokers and dealers, in an effort to eliminate duplicate regulation of SECO municipal securities brokers and dealers.

13. *Rule 15c3–4.* The Commission staff is presently studying the possibility of proposing a new Rule 15c3–4 under the Securities Exchange Act, which would set forth revised standards regarding the borrowing of securities by brokers or dealers.

14. *Rule 15Bc7–1.* The Commission may consider the proposal of Rule 15Bc7–1, to assure the confidentiality of examination reports supplied to the Municipal Securities Rulemaking Board.

15. *Form MSD.* The Commission may consider the adoption of amendments to Form MSD, the form required to be filed for registration as a municipal securities broker or dealer, to permit the use of schedules prepared for bank regulatory agencies and otherwise to clarify the Form.

16. *Section 12(f) Applications.* The Commission may consider the proposal of rules under the Securities Exchange Act governing the information to be supplied in applications for unlisted trading privileges pursuant to Section 12(f) and enunciating the standard to be applied by the Commission in reviewing such applications.

17. *Options Study Recommendations.* The Commission will consider the steps that the self-regulatory organizations are taking to comply with certain of the recommendations contained in the Special Study of the Options Markets, recently released, and the steps the Commission must take to address certain other recommendations. For further information, see Securities Exchange Act Release No. 15575 (February 22, 1979) (44 FR 11876).

18. *Underwriting Practices.* The National Association of Securities Dealers filed a proposed rule change in June 1978, dealing with underwriting practices. The initial impetus for the proposed rule change was the Federal district court decision in *Papilsky* v. *Berndt* [1976–77 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 95,627 (S.D.N.Y., 1976). The Commission will consider what action to take with respect to the rule proposal after the staff completes its review of the public comments. For further information, see Securities Exchange Act Release No. 15020 (August 2, 1978) (43 FR 35446).

C. Significant Initiatives Affecting Investment Companies and Investment Advisers

1. *"Start-Up" Exemptions for Unit Investment Funds.* The Commission has recently solicited public comment on a proposal, which would provide "start-up" exemptions from the provisions of the Investment Company Act of 1940 for unit investment trusts, to make certain routine applications for exemption unnecessary. The Commission will consider this proposal upon completion of the staff review of the public comments. For further information, see

Investment Company Act Release No. 10545 (January 8, 1979) (44 FR 3376).

2. *Proposed Rule 434(d).* The staff of the Commission is presently studying the public comments received concerning proposed Rule 434(d) under the securities Act of 1933, which would permit investment companies to use "summary prospectuses." The Commission will consider whether to adopt the proposed rule after the staff has completed its review of the public comments. For further information, see Securities Act Release No. 5833 (June 8, 1977) (42 FR 30379).

3. *Bearing of Distribution Expenses by Mutual Funds.* The staff is presently studying public comments received on a concept release which raised the issue of whether it would be appropriate to propose a rule under Section 12(b) of the Investment Company Act dealing with the circumstances under which investment companies could finance the distribution of their own shares. At the conclusion of the staff reveiw, the Commission may consider the proposal of a rule. For further information, see Investment Company Act Release No. 10252 (May 23, 1978) (43 FR 23589).

4. *Rule 17j–1.* The Commission has proposed the adoption of revised Rule 17j–1 under the Investment Company Act, requiring investment companies to develop codes of ethics governing purchases or sales by investment company insiders of the same securities held or to be acquired by the investment company. The Commission will shortly consider whether to adopt the proposed rule. For further information, see Investment Company Act Release Nos. 10162 (March 20, 1978) (43 FR 12721) and 10222 (April 28, 1978) (43 FR 19669).

5. *Rule 10f–3.* The Commission has proposed for public comment amendments to Rule 10f–3 under the Investment Company Act, which would expand the circumstances and streamline the procedures under which investment companies may participate in underwritings in which affiliated persons are participating. After the close of the comment period, on March 30, 1979, the Commission will consider the proposed amendments. For further information, see Investment Company Act release No. 10592 (February 13, 1979) (44 FR 10580).

6. *Proposed Rule 17e–2.* The Commission has recently invited public comment on proposed Rule 17e–2 under the Investment Company Act, which defines what is a "usual and customary" brokerage fee for purposes of Section 17(e)(2)(A). The Commission will consider whether to adopt the proposed rule upon completion of the staff study following the close of the public comment period. The public comment period expires on April 13, 1979. For further information, see Investment Company Act Release Nos. 10605 and 10606 (February 27, 1979) (44 FR 12202 and 102204).

7. *Rule 154.* The staff is presently examining public comments to determine whether the Commission should adopt a revised Rule 154, under the Securities Act, governing the circumstances under which guaranteed investment contracts issued by insurance companies may constitute securities requiring registration. Consideration of this matter is anticipated during the first half of 1979. For further information, see Securities Act Release No. 5933 (May 17, 1978) (43 FR 22053).

D. Accounting Related Initiatives

1. *Review of Regulation S–X.* In response to a recommendation in the 1977 Report of the Advisory Committee on Corporate Disclosure, the staff is currently reviewing Regulation S–X, which governs the form and content of financial statements filed with the Commission, to identify requirements which needlessly duplicate generally accepted accounting principles. Following this review, the staff intends to recommend to the Commission amendments to Regulation S–X to eliminate any such duplication.

2. *Management Reports.* In its 1978 Report, the Commission on Auditors' Responsibilities, an independent commission established by the American Institute of Certified Public Accountants, encouraged companies to publish reports acknowledging the responsibility of management for the representations in financial statements and discussed specific areas which might be covered by such a report. Following completion of relevant staff analyses, the Commission may consider proposals to seek public comment on the feasibility and desirability of requiring such reports, as well as on the form and content which should be required.

3. *Reporting on Internal Control.* In 1977, the Foreign Corrupt Practices Act amended the Federal securities laws to require, among other things that certain registrants devise and maintain a system of internal control sufficient to provide certain specified reasonable assurances. This legislation provided added dimensions to registrants' existing responsibilities to assure adequate controls and reliable reports on operations. Prior to passage of the Act, the Report of the Commission on Auditors' Responsibilities had recommended discussion on the internal accounting systems of companies in the proposed management reports discussed above. The staff currently has under consideration proposals to require reports by management on their internal control systems and examination of such reports by independent public accountants.

4. *Presentation in Financial Statements of Preferred and Common Stocks.* In November 1978, the Commission proposed amendments to Regulation S–X to require separate balance sheet presentation of preferred stocks subject to mandatory redemption requirements or the redemption of which is outside the control of the issuer, preferred stocks which are not redeemable or are redeemable solely at the option of the issuer, and common stocks. Following staff review of public comments received, the Commission will determine whether to adopt, withdraw or repropose the proposed rule. For further information, see Securities Act Release No. 6000 and Securities Exchange Act Release No. 15358 (November 28, 1978) (43 FR 57612).

5. *Proposed Oil and Gas Supplemental Earnings Summary.* In August 1978, in conjunction with announced decisions on financial accounting and reporting on oil and gas producing activities, the Commission proposed rules requiring the presentation of a supplemental earnings summary of oil and gas producing activities that would recognize changes in the present value of estimated future revenues from production of proved oil and gas reserves in income and include in expenses all costs of finding and developing additions to proved reserves. The Advisory Committee on Oil and Gas Accounting has been requested to analyze the Commission's proposal in detail, and to consider and propose amendments and modifications which would minimize the burden and maximize the utility of the proposed summary. Following staff consideration of the public comments and the recommendations of the Advisory Committee, the Commission will consider the next appropriate steps to take on its proposal. For further information, see Securities Act Release No. 5969 and Securities Exchange Act Release No. 15111 (August 31, 1978) (43 FR 40726).

6. *Report on the Accounting Profession.* In June 1977, the Chairman of the Commission indicated to Congress that the Commission would report periodically on the response of the accounting profession to the challenges which Congress and others

had placed before it and on the Commission's own initiatives in this area. The Commission submitted its first Report to Congress on the Accounting Profession and the Commission's Oversight Role in July 1978. The Commission intends to submit a second report in July 1979.

E. Consumer Protection Studies

1. The staff is continuing its efforts to improve the means by which broker–dealers and public investors can resolve their disputes. Among the matters being studied are the inclusion of predispute arbitration clauses in agreements between brokers-dealers and public investors and the participation of SECO broker-dealers in a uniform investor dispute resolution system which could provide for arbitration on demand by the public customers of all broker-dealers. These studies may result in rule proposals being submitted for Commission consideration during 1979.

2. The Commission has received a preliminary proposal from the Securities Industry Conference on Arbitration dealing with a uniform arbitration code and related administrative procedures which the staff is presently reviewing. It is anticipated that this initial submission will be followed by applications from self-regulatory organizations for proposed rule changes, pursuant to Rule 19b–4 under the Securities Exchange Act, to implement a uniform arbitration code.

By the Commission.

George A. Fitzsimmons,

Secretary

March 22, 1979.

[Release Nos. 33–6040; 34–15670; Ic–10636; IA–671]

[FR Doc. 79–10103 Filed 4–3–79; 8:45 am]

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federal register

Wednesday
April 4, 1979

Part V

Securities and Exchange Commission

Development of a National Market System

SECURITIES AND EXCHANGE COMMISSION

Development of a National Market System

AGENCY: Securities and Exchange Commission.

ACTION: Status report.

SUMMARY: The Commission assesses the progress made in 1978 toward the establishment of a national market system and sets forth its views as to the next steps which should be taken to achieve that goal.

DATES: Not applicable.

ADDRESSES: Interested persons are invited to provide written comments regarding this status report and the issues discussed herein. Commentators should file six copies of their submissions with George A. Fitzsimmons, Secretary, Securities and Exchange Commission, Room 892, 500 North Capitol Street, Washington, D.C. 20549. All submissions should refer to File No. S7-735-A and will be available for public inspection at the Commission's Public Reference Room, Room 6101, 1100 L Street, N.W., Washington, D.C.

FOR FURTHER INFORMATION CONTACT: Brandon Becker, Division of Market Regulation, Securities and Exchange Commission, Room 321, 500 North Capitol Street, Washington, D.C. 20549 (202) 755-8749.

SUPPLEMENTARY INFORMATION: On January 26, 1978, the Commission issued a statement on the development of a national market system ("January Statement").[1] In that Statement, the Commission provided a discussion of the objectives of a national market system and set forth its views as to those steps which it believed should be taken during 1978 to facilitate development of a national market system as envisioned by the Congress in the Securities Acts Amendments of 1975 (the "1975 Amendments").[2] This status report assesses the progress made during the past year in pursuing the initiatives described in the January Statement and indicates the Commission's views as to those issues which next should be resolved and those steps which next should be taken to continue progress towards a national market system.

Introduction

In order to provide some perspective for the Commission's evaluation of the past year and its expectations for the coming year, it is important to set forth some general comments about the Commission's national market system program. The Commission continues to believe that the development of a national market system should be an evolutionary process. The Commission's role in this process is to monitor and encourage industry progress, to act as a catalyst and, when necessary, to take regulatory action to achieve a particular goal. However, the Congress did not intend that the Commission dictate the ultimate configuration of the national market system or, through regulatory fiat, force all trading into a particular mold.[3] Instead, the Congress (and the Commission) expected that the securities industry would assume primary responsibility for the development of facilities necessary to achieve the objectives set forth by Congress in Section 11A of the Act.

Although some significant steps were taken during the past year, the Commission believes that progress towards a national market system cannot usefully be gauged by reference alone to the number of Commission rules proposed or adopted or the number of facilities initially implemented or improved within a particular time frame. Meaningful progress can be achieved—and unintended and harmful consequences avoided—only through development and modification of facilities and rules which constitute the foundation of a national market system. As new components of the national market system are implemented, there necessarily will be a period of learning and adjustment. Only after an opportunity to monitor actual on-line experience with these components—whether facilities or regulatory initiatives—can the Commission and the industry evaluate whether a particular component achieves its intended goal.

During the past year, the Commission and the industry have made significant progress towards achievement of some of the objectives of a national market system and, more particularly, certain of the initiatives described in the January Statement.[4] In addition, through comments and industry proposals submitted in response to the January Statement,[5] the self-regulatory organizations and the securities industry have increased their collective commitment to enhance and perfect market linkage and information systems and to address unresolved policy and technological concerns.

During 1978, there were two major national market system facilities

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[1] Securities Exchange Act Release No. 14416 (January 26, 1978), 43 FR 4354.

[2] *Id.* at 26, 43 FR at 4358. Section 11A of the Securities Exchange Act of 1934 (the "Act") [15 U.S.C. 78a *et seq.*, as amended by the 1975 Amendments (Pub. L. No. 94-29) (June 4, 1975)], directs the Commission to "facilitate the establishment of a national market system for securities . . . in accordance with the findings and to carry out the objectives set forth in [Section 11A(a)(1) of the Act. 15 U.S.C. 78k-1(a)(1)]". Section 11A(a)(2) [15 U.S.C. 78k-1(a)(2)]. The January Statement contains an abbreviated history of the evolution of the national market system concept. January Statement, *supra* note 1, at 5-18, 43 FR at 4354-6.

[3] In directing to the Commission to facilitate the establishment of a national market system, the Congress articulated the objectives to be sought in a national market system and specified the basic underlying principles which should govern the establishment of that system; however, the Congress neither defined the term "national market system" nor mandated specified minimum components of such a system. As the Senate Committee stated in its *Report to Accompany S. 249* (the legislative proposal that provided the foundation for Section 11A of the Act): "The Committee considered mandating certain minimum components of the national market system but rejected this approach. The nation's securities markets are in dynamic change and in some respects are delicate mechanisms; the sounder approach appeared to the Committee, therefore, to be to establish a statutory scheme clearly granting the Commission broad authority to oversee the implementation, operation, and regulation of the national market system and at the same time to [*sic*] charging [the Commission] with the clear responsibility to assure that the system develops and operates in accordance with Congressionally determined goals and objectives." Senate Comm. on Banking, Housing, and Urban Affairs, *Report to Accompany S. 249*, S. Rep. No. 94-75, 94th Cong., 1st Sess. 8-9 (Comm. Print 1975), *reprinted in*, [1975] U.S. Code Cong. & Ad. News 179, 186-87 ("Senate Report"). *See* January Statement, *supra* note 1, at 12-13, 43 FR at 4355.

[4] The market structure program described in the January Statement consisted of six interrelated initiatives: the development and implementation of three new national market system facilities (a consolidated quotation system a nationwide network of order routing facilities and a central public agency limit order file), the refinement of an existing national market system facility (the consolidated transaction reporting system), the commencement of rulemaking proceedings to consider designation of certain categories of securities as qualified for trading in the national market system, and the continued consideration of off-board trading rules in light of the progress made toward a national market system. The January Statement also indicated that the Commission anticipated consideration of certain corollary issues in conjunction with this program, including institutional trading prohibitions, options market structure, governance and surveillance, the provisions of Section 11(a) of the Act, and clearance and settlement.

[5] The Commission has received responses from the American Stock Exchange, Inc. ("Amex"), Boston Stock Exchange, Inc. ("BSE"), Chicago Board Options Exchange, Inc. ("CBOE"), Cincinnati Stock Exchange, Inc. ("CSE"), Midwest Stock Exchange, Inc. ("MSE"), New York Stock Exchange, Inc. ("NYSE"), Pacific Stock Exchange, Inc. ("PSE"), Philadelphia Stock Exchange, Inc. ("Phlx") and the National Association of Securities Dealers, Inc. ("NASD"). We have also received comments from the Securities industry Association ("SIA") and other trade groups, various brokerage firms, securities information vendors and corporate issuers as well as numerous individuals. All of these comments are publicly available in the Commission's File No. S7-735-A.

developments. The first was implementation of a Commission rule requiring all market centers to collect and make available "firm" quotation information (including size) [6] to securities information vendors for dissemination to market professionals and the investing public.[7] Although the rule contains exceptions to firmness to accommodate certain operational characteristics of current exchange trading and quotation collection procedures,[8] a functioning consolidated quotation system, long considered a cornerstone of a national market system, has become operational, and quotation information for reported securities is now an integral part of the nation's securities market.[9]

Significant steps also have been taken toward implementation of comprehensive market linkage systems. Two experimental programs intended to achieve such linkages commenced operation during 1978. One of these, the Intermarket Trading System ("ITS"), was developed jointly by several exchanges and is designed to permit orders for the purchase and sale of multiply-traded securities to be routed between market centers for execution.[10] The other system, the Cincinnati Stock Exchange multiple-dealer trading facility ("CSE System"), represents an experiment in the use of a fully automated, electronic trading system.[11]

The Commission believes that these systems evidence considerable progress in the application of automation and computer and communications technology to overcome some of the problems associated with market fragmentation. In the Commission's view, the ITS and the CSE System both offer valuable opportunities for increased competition and for the Commission and the brokerage community to assess the ability of differing types of market linkage systems to integrate trading in physically separate locations and to observe the effects of these linkage systems on the operation of the markets. Both types of market linkage systems, separately or in some combination, may become permanent features of a national market system, either because it becomes clear that both systems, notwithstanding their differing operational characteristics, are compatible, or because the different trading characteristics of some securities make use of one type of market linkage system more economical and efficient for those securities than the other.[12]

In addition to this tangible progress towards a national market system the January Statement, by establishing a specific detailed program, focused the attention of the self-regulatory organizations, the securities industry and the investing public on significant unresolved issues relating to the development of a national market system. Through the various comments received, considerable progress has been made in refining the views of the

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[6] Quotations made available pursuant to this rule are required, subject to certain exceptions, to be "firm"; *i.e.*, brokers and dealers are required to execute an order presented to them at their displayed quotation price up to the amount of their displayed quotation size or better.

[7] Rule 11Ac1-1 under the Act [17 CFR 240.11Ac1-1], which became effective August 1, 1978, requires each self-regulatory organization to collect, process and make available to securities information vendors quotations and quotation sizes for all securities ("reported securities") as to which last sale information is included in the consolidated transaction reporting system contemplated by Rule 17a-15 under the Act [17 CFR 240.17a-15]. *See* Securities Exchange Act Release No. 14415 (January 26, 1978) ("Quotation Release"), 43 FR 4342.

[8] These exceptions are for revised quotations and unusual market conditions. Rule 11Ac1-1(b)(3) and (c)(3).

[9] Quotations from all market centers (including third market makers) subject to Rule 11Ac1-1, other than CSE, are being made available in a single consolidated data stream processed by the Securities Industry Automation Corporation ("SIAC"). Although Rule 11Ac1-1, unlike Rule 17a-15, does not require reporting self-regulatory organizations to file plans for the dissemination of quotation information, the Commission, in the release announcing the adoption of Rule 11Ac1-1, encouraged the exchanges and the NASD to consider joint implementation of Rule 11Ac1-1 on a voluntary basis. *See* Quotation Release, *supra* note 7, at 51-52, 43 FR 4349.

In response to this statement, in April 1978, representatives of the Amex, BSE, CSE, MSE, NASD, NYSE, PSE and Phlx met to discuss the possibility of developing a joint plan for the implementation of Rule 11Ac1-1. The neogtiations regarding the proposed plan and technical problems encountered by certain regional exchanges in connection with the installation of automated quotation generation equipment prompted the Commission to defer the effective date of Rule 11Ac1-1 from May 1, 1978 to August 1, 1978. Securities Exchange Act Release No. 14711 (April 27, 1978), 43 FR 18556. On July 25, 1978, a "Plan for the Purpose of Implementing Rule 11Ac1-1 under the Securities Exchange Act of 1934" ("CQ Plan") was filed.

On July 28, 1978, the Commission declared the CQ Plan effective on a temporary basis pursuant to Section 11A(a)(3)(B) of the Act. (Securities Exchange Act Release No. 15009 (July 28, 1978), 43 FR 34851) and on August 1, 1978, pursuant to the CQ Plan, the Amex, BSE, MSE, NYSE, PSE and Phlx commenced disseminating quotations to vendors in a single data stream. On January 24, 1979, the Commission extended its temporary approval of the CQ Plan for an additional 12 months (Securities Exchange Act Release No. 15511 (January 24, 1979), 44 FR 6230), and, on February 20, 1979, quotations of third market makers (collected by the NASD) were added to the consolidated quotation data stream.

During 1978, the Commission published for comment new proposals designed to refine the operation of the consolidated transaction reporting and quotation systems. The first of these proposals, proposed Rule 11Ac1-2 under the Act [17 CFR 240.11Ac1-2], would impose comprehensive minimum requirements regulating the manner in which securities information vendors display transaction and quotation information. Securities Exchange Act Release No. 15251 (October 20, 1978), 43 FR 50615.

The second proposal would amend existing Rule 17a-15 to: (i) redesignate Rule 17a-15 as Rule 11Aa3-1 under the Act; (ii) eliminate (subject to certain conditions) the existing prohibition on retransmission of last sale data for purposes of creating a moving ticker display; and (iii) set forth procedures for amending transaction reporting plans filed pursuant to the Rule. Securities Exchange Act Release No. 15250 (October 20, 1978), 43 FR 50606.

[10] In the January Statement, the Commission called for the prompt development of market linkage systems to permit orders in qualified securities to be promptly and efficiently transmitted from one qualified market center to another. January Statement, *supra* note 1, at 28-33, 43 FR at 4358. On March 9, 1978, the Amex, BSE, NYSE, PSE and Phlx jointly filed with the Commission a "Plan for the Purpose of Creating and Operating an Intermarket Communication Linkage" ("ITS Plan"). On April 14, 1978, the Commission issued a temporary order pursuant to Section 11A(a)(3)(B) of the Act approving the implementation of the ITS for a period of 120 days and, on August 11, 1978, the Commission extended that approval for an additional year. Securities Exchange Act Release Nos. 14661 (April 14, 1978) and 15058 (August 11, 1978), 43 FR 17419 and 36732. As of this date, all self-regulatory organizations other than the CSE and NASD are participating in the ITS and approximately 332 securities are currently traded through the system. The ITS participants expect that 550-600 securities will be traded in the system by July 1, 1979, and discussions are continuing between the ITS participants and the NASD regarding linking "third market" dealers through the ITS.

[11] On April 18, 1978, the Commission approved a proposed CSE rule change permitting the implementation of the CSE System on a nine month pilot basis. Securities Exchange Act Release No. 14674 (April 18, 1978) ("CSE System Approval"), 43 FR 17894. On December 15, 1978, the Commission extended its approval of the CSE System for an additional year. Securities Exchange Act Release No. 15413 (December 15, 1978) ("CSE System Extension"), 44 FR 129. On February 14, 1979, a subsidiary of Control Data Corporation became the facilities manager for the CSE System.

The CSE System, through an electronic communications network maintained by the CSE, enables CSE members, without the necessity of maintaining a presence on the floor of the CSE or any other exchange, to participate in a market conducted in accordance with certain auction-type trading principles by entering bids and offers for securities for their own account and as agents for their customers' accounts. In addition, CSE rules permit a specialist on any national securities exchange, without becoming a member of the CSE, to enter bids and offers in the system as principal or as agent in any security in which that specialist is registered on another exchange. Orders entered into the CSE System are stored in the CSE's computer facilities and queued for execution as follows: priority is governed first by price (*i.e.*, the highest bid and lowest offer) and second, as between orders at the same price, by time of entry. However, public agency orders as defined in the CSE's rules, regardless of time of entry, are granted priority over other orders at the same price.

[12] For example, the type of trading environment which is most appropriate for a particular security may prove to be related to the level of trading activity and multiple trading interest for that security. If so, then some securities may be better suited to a market environment characterized primarily by appropriately linked market centers, while other securities may be better suited to trading through a market linkage facility similar to the CSE System.

Commission and the industry with repect to the appropriate characteristics of order routing and limit order facilities and the role these facilities should play in a national market system.[13] These comments have been carefully considered by the Commission in formulating its views expressed in this status report.

During 1979, the Commission will continue its efforts to identify and reduce to specifics those steps necessary to the achievement of a national market system, taking such regulatory action, from time to time, as appears necessary or appropriate to facilitate the establishment of that system. While the Commission expects further progress in a number of areas, discussion here is limited to those areas in which the Commission believes more direction and immediate attention are especially important.

The Commission's first priority is the achievement of nation-wide price protection for public limit orders against executions at inferior prices. The Commission believes that, although certain technological problems must be resolved—such as the perfection of mechanisms necessary to achieve the efficient intermarket execution of orders and the collection and display of limit order information—realization of this goal and implementation of, at a mimimum, a pilot program providing price protection for a limited number of qualified securities should be achieved within the next 12–18 months.[14] In addition, the Commission believes that progress should be made during 1979 to assure the general availability of neutral order routing facilities linking brokers' and dealers' offices to all market centers trading reported securities.[15] Finally, the Commission intends promptly to initiate rulemaking proceedings to consider redefinition of the trading environment for securities now traded exclusively over-the-counter when those securities become listed or admitted to unlisted trading privileges on an exchange for the first time.[16] The remainder of this status report will describe in detail the Commission's expections for further progress.

Discussion

1. Nation-wide Price Protection

One of the essential elements of the Commission's program announced in the January Statement was the creation of a mechanism by which nation-wide protection for limit orders would be assured. Specifically, the Commission proposed the development of a central limit order file ("Central File") into which public agency limit orders ("public limit orders")[17] could be entered and queued for execution in accordance with the auction-type principles of price and time priority.[18] The Commission requested each self-regulatory organization to inform the Commission of its willingness to undertake joint implementation of a Central File and urged the self-regulatory organizations to submit a joint plan for its design, construction and operation.

In response to this request, the Commission received several proposals describing alternative means of achieving the goal of nation-wide limit order protection. The NASD submitted a "Technical Plan for the Development of a National Market System" ("Technical Plan") describing an electronic facility (based upon the technology and hardware of the existing NASDAQ system) functionally similar to the Central File proposed by the Commission. The Technical Plan contemplates that any qualified broker could enter limit orders into the facility for execution by qualified market makers based upon price and time priority within the system. The NASD's Board of Governors, however, expressly reserved judment on the policy and regulatory issues associated with implementation of the facility described in the Technical Plan. Specifically, the NASD noted that further study was necessary to determine whether exclusion of non-public limit orders from the Central File and whether protection of orders entered in the file against executions at the same price as well as executions at an inferior price would be appropriate.[19]

Most other self-regulatory organizations opposed creation of a Central File as described in January Statement. These commentators argued that the absolute time priority proposed to be afforded public limits orders entered in the Central File[20] would have significant deleterious effects on the exchange trading process. In essence, these commentators asserted that such a preference for public limit orders would provide a major trading advantage to these orders, thereby creating a disincentive to the commitment of market making capital by dealers,[21] and would eventually lead to the elimination of exchange trading floors by inexorably forcing all trading into a fully automated trading system. In addition, several self-regulatory organizations suggested that, in lieu of the immediate implementation of a Central File, the Commission should permit the ITS participants sufficient time to attempt to provide limit order protection through the ITS. Specifically, the NYSE and MSE submitted proposals which envision the electronic dissemination and display of limit order information from each market center and use of the ITS to assure intermarket price protection of displayed limit orders in any market.[22] The MSE also suggested that the Commission adopt a rule requiring protection of all such displayed limit orders against executions at an inferior price.[23]

While the Commission cannot predict accurately the consequences of implementing a limit order protection system based on affording orders entered in a Central File priority over all other buying and selling interest, the Commission recognizes the possibility that introduction of a system based upon the absolute time priority concept could have a radical and potentially disruptive impact on the trading process as it exists today. Therefore, industry and Commission efforts should be concentrated on the achievement of nation-wide protection for all public limit orders based on the principle of price priority.

The Commission believes that nation-wide price protection—whereby any appropriately displayed public limit order[24] for a qualified security[25] is assured of receiving an execution prior

[13] *See* text *infra* at notes 16–35 and 40–52.

[14] *See* text *infra* at note 29.

[15] *See* text *infra* at notes 46–52.

[16] *See* text *infra* at notes 52–54.

[17] The Commission defined "public limit order" as "any limit order not for the proprietary account of a broker or dealer." January Statement, *supra* note 1, at 34 n. 52, 43 FR at 4359 n. 52.

[18] *See* January Statement, *supra* note 1, at 34–35, 43 FR at 4359.

[19] *See* letter from Gordon S. Macklin, President, NASD, to George A. Fitzsimmons, Secretary, SEC, May 30, 1978, contained in File No. S7–735–A.

[20] In the January Statement, the Commission proposed that public limit orders entered in the Central File would have absolute priority over all other orders at the same price. *See* January Statement, *supra* note 1, at 35–36, 43 FR at 4359.

[21] *See* letter from Richard B. Walbert, President, MSE, to George A. Fitzsimmons, Secretary, SEC, November 24, 1978 ("MSE Letter"), contained in File No. S7–735–A, at 34–38.

[22] *See* letter from James E. Buck, Secretary, NYSE, to George A. Fitzsimmons, Secretary, SEC, May 31, 1978, ("NYSE Letter"), contained in File No. S7–735–A, and MSE Letter, *supra* note 21.

[23] *See* MSE Letter, *supra* note 21 at 42–43.

[24] For purposes of this discussion, the term "public limit order" should be construed as any limit order to purchase or sell a qualified security not for the proprietary account of a broker or dealer or any person associated with a broker or dealer which is entered into a market center's limit order repository (whether that be a specialist's book or some other similar mechanism) and displayed in other market centers. *Cf.* note 17, *supra*.

[25] Section 11A(a)(2) of the Act empowers the Commission to designate as "qualified securities" those securities or classes of securities qualified for trading in the national market system. *See* text *infra* at notes 54–55.

to any execution by a broker or dealer at an inferior price—should be a basic characteristic of a national market system.[26] As an initial step towards this end, the Commission believes that the proponents of the ITS should be afforded time to experiment with and further enhance that system as a means of providing intermarket price protection for public limit orders. The commentary submitted by most self-regulatory organizations evidences a common commitment to achievement of this type of protection and a willingness to take all technical steps necessary to reach this goal.

In the Commission's view, two types of initiatives are necessary to achieve nation-wide price protection for displayed public limit orders by means of the ITS. First, the self-regulatory organizations and the securities industry must determine to resolve collectively the various practical and technical problems associated with disseminating and displaying public limit order information from each market center and with promptly enhancing the ITS so that it may serve as a means by which price protection for public limit orders can be afforded on an intermarket basis. Thus, each self-regulatory organization must develop a means of storing public limit order information[27] and disseminating that information for electronic display in all other market centers.

In addition, if the ITS is to provide a mechanism for the routing of orders easily and efficiently for execution against public limit orders in other markets, certain of its operating characteristics must be substantially improved. Foremost among the necessary changes is a reduction in the length of time required to enter commitments to trade and receive execution or rejection reports. Currently, the complexity of order entry procedures and the two-minute time interval provided for execution or rejection appears to discourage brokers from using the system, particularly during periods of active trading. Although the ITS participants are experimenting with a one-minute time period, this enhancement would appear to be insufficient if ITS is to be used for the purpose of ensuring nation-wide public limit order protection. Ultimately, the exigencies of active trading in multiple locations probably will require systems enhancements which reduce response times to significantly less than one minute.[28]

In furtherance of this necessary collective effort, the Commission is requesting each self-regulatory organization to inform the Commission in writing, by May 1, 1979, of its commitment to work actively with other such organizations to develop in concert and submit to the Commission by September 1, 1979, a joint plan specifying a series of planned steps by which the mechanisms to provide price protection for all public limit orders will be developed and implemented, at least on a pilot basis, not later than the end of calendar year 1980.[29]

The second initiative necessary for the achievement of nation-wide price protection for public limit orders is the proposal of a Commission rule prohibiting any broker or dealer from executing any order to buy or sell a qualified security at a price inferior to the price of any displayed public limit order unless the broker or dealer assures that, simultaneously with or immediately after execution, those limit orders displayed at the time of execution are satisfied at the limit price or such better price as may be required by the principles of gap print pricing.[30] Within the next few months, the Commission expects to propose such a rule, contemplating an effective date sufficiently distant to afford time for the industry to design and put in place procedures and facilities needed to assure price protection for all public limits orders in qualified securities.

Because the Commission views the development and implementation of the facilities component of the national market system as primarily a self-regulatory organization and industry responsibility, the Commission believes that an appropriate opportunity should be provided the self-regulatory organizations to achieve the goal of nation-wide price protection for public limit order in the manner contemplated in the MSE and NYSE[31] submissions—namely, through a multiple-market display of limit orders and an enhanced ITS. However, if it appears that the ITS, even with enhancements, cannot adequately meet the needs of market

[26] Policy considerations relating to so-called "gap print pricing": *i.e.*, the execution of limit orders at the "cleanup" price of a block transaction (*see, e.g.*, NYSE Rule 127), while necessary to resolve prior to the implementation of a rule requiring intermarket price protection for block orders, would not appear to affect the system design of the facilities used to achieve that result. As a preliminary matter, the Commission believes that, unless compelling arguments are presented to the contrary, gap print pricing for displayed public limit orders away from the market should be a characteristic of price protection in the national market system.

[27] The Commission does not believe that it is necessary for every market to create facilities permitting the electronic storage of limit orders. The option to develop such a mechanism should be left to each self-regulatory organization, provided that an effective means of disseminating that information to other market centers for electronic display purposes is achieved. The Commission notes, however, that the NYSE has proposed to develop its own electronic repository for limit orders routed to the NYSE and the Commission encourages the NYSE to proceed with the implementation of this facility.

[28] Delays in the transmission and execution of orders between markets may disrupt trading on both sending and receiving markets. Those delays may prevent the completion of transactions on the sending market pending receipt of execution reports and may create sequencing difficulties on the receiving market. For example, if a broker desires to execute a block on a regional exchange at 19¾ (a price away from the current market), nation-wide price protection for public limit orders would require the broker to delay execution of that part of the block which might be off-set by displayed public limit orders at a better price pending receipt of an execution or rejection with respect to those orders. Thus, if another market is then displaying a public limit order to buy 200 shares at 19⅞, the broker handling the block would be required to send a 200 share order for execution on the other market. If execution of the 200 share order were delayed, due to the inefficiency of the sending and execution mechanism, there would be an increased likelihood that additional public limit orders (for example, an order to buy 100 shares at 20) would be placed on the specialist's book prior to execution of the 200 share order. In this event, presumably the 200 share order at 19⅞ would be executed, notwithstanding the normal priority of the 100 share order at 20, since only those orders displayed at the moment of transmission would be entitled to protection. *See* text *infra* at notes 33–34. The incidence of such anomalies, however, will be reduced as mechanisms for transmitting and executing orders between markets are refined to reduce response times.

[29] If the self-regulatory organizations are unable to agree on an appropriate plan to achieve nation-wide price protection for public limit orders, the Commission will consider whether to use its authority under Section 17(d) of the Act to allocate to a single entity the self-regulatory responsibility for providing a framework for achieving the goal or for carrying out a Commission design of a menas to that end.

[30] *See* note 26 *supra*. Of course, the creation of this explicit obligation would in no way limit a broker's existing duty to seek to obtain best execution of his customers' orders. *See* Restatement (Second) of Agency § 424 (1957). *Cf.* Newman v. Smith, [1974–75 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,078 at 97,782, 97,784–85 (S.D.N.Y., No. 70, Civ. 1987 WCC, Apr. 24, 1975); *In re* Wittow, 44 S.E.C. 668, 689 (1971); *In re* Thomson & McKinnon, 43 S.E.C. 785, 788–89 (1968). *See also* Horst v. W. T. Cabe & Co., [1977–78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,213 at 92,461, 92,464 (S.D.N.Y., No. 76, Civ. 1782, Oct. 31, 1977).

[31] Unlike the MSE, the NYSE suggested that intermarket price protection should be provided on a voluntary basis, rather than by imposition of a rule requiring such price protection. The NYSE stated: "Undoubtedly competitive pressures will force each market center's participants to reach out through ITS for better prices, rather than to effect executions in their own market centers at inferior prices. The [NYSE], for its part, will also strongly encourage its members to reach through ITS any time a better price is available anywhere in the system. These pressures, consistent with an agent's responsibilities to his customer, will protect limit orders throughout the system against transactions at inferior prices." NYSE Letter, *supra* not 22, at 25. Although the Commission has determined to propose a rule requiring that such intermarket price protection be provided, we solicit comment on whether the voluntary procedures suggested by the NYSE would provide the same degree of price protection.

professionals in an environment characterized by an affirmative obligation to provide inter-market price protection for public limit orders, the Commission is prepared to explore alternative mechanisms for reaching this goal. For example, as an alternative to the MSE and NYSE proposal, limit orders from varying locations could be entered into an electronic trading facility modelled after the CSE System, and executed against those orders directly by market makers in any market center. Similarly, a Central File of the type described in the January Statement, modified to remove priority for orders stored in the File over other orders at the same price in the various market centers, could provide an efficient and effective means for assuring system-wide price protection.

Notwithstanding the Commission's commitment to achieve nation-wide price protection for public limit orders, the Commission seek comment on whether there are any regulatory, policy of practical reasons to limit the application of the price protection concept to orders of this particular type. It may be that, in addition to protection for public limit orders, price protection can easily be afforded to all displayed orders at the market,[32] whether public or professional, such that any displayed quotation would be entitled to price protection up to the amount of its associated quotation size. Indeed, it may be that providing price protection to all buying and selling interest collected by a particular market center and disseminated by that market center as part of its current bid or offer will not only improve liquidity but also avoid a number of practical problems and trading anomalies which seem certain to arise from restricting price protection to public limit orders.

For example, in order to provide price protection for public limit orders at the market, but not for other buying and selling interest displayed as part of the current quotation, it will be necessary to develop a separate composite display of prices and sizes reflecting that portion of each market center's current quotation represented by public limit orders.[33] Second, confinement of nation-wide price protection to public limit orders could result in buying and selling interest at the market in a given market center (*e.g.*, representing dealer interest) being bypassed as public limit orders in that market at inferior prices are required to be filled by orders transmitted from the another market. The following hypothetical example illustrates this possibility. Assume that a broker desired to effect the sale of a block of stock *X* in a particular market center at a price of 19¾—a price below a bid for stock *X* at 20 displayed by another market center. Further, assume that the bid at 20 represents either a public order in the crowd or a specialist's bid for his own account rather than a public limit order. Finally, assume that, in the market whose published bid was 20, there public limit orders to buy stock *X* on the specialist's book at 19⅞. Under a rule requiring nation-wide price protection only for public limit orders, the broker effecting a trade at 19¾ would have to satisfy the displayed limit orders at 19⅞ but not the buying interest at 20. Such an execution sequence would yield a result significantly different from that secured under the rules of priority, parity and precedence now in effect on national securities exchanges.[34]

For these reasons, it would appear that, if nationwide price protection is to be accomplished in a fair manner consistent with the purposes of the Act, it ultimately should encompass protection for all buying and selling interest displayed by a particular market center as part of its current bid or offer—regardless of whether or not that interest is comprised of public limit orders—as well as all displayed public limit orders away from the market at prices superior to the price of a proposed trade. In this context, nation-wide price protection for public limit orders should be viewed as an interim step toward, and experiment in, the achievement of price protection for all displayed orders. The techniques developed to implement this interim goal should provide valuable experience in assessing the practicability of requiring price protection for all displayed orders in the future.

The Commission is interested in receiving the views of the self-regulatory organizations, the securities industry and the investing public as to (i) whether the goal of price protection for all orders at the market is desirable and feasible, and, if so, (ii) whether it would be appropriate to bypass the interim step of providing price protection for public limit orders and proceed directly to the enhanced goal. Persons favoring proceeding directly to price protection for all orders at the market, as well as limit orders away from the market, should discuss any technical or practical problems not present in achieving such protection only for public limit orders and whether achievement of the enhanced goal directly would require a greater lead time than achievement of the interim goal.

2. Use of Market Linkage Facilities

Apart from the usefulness of experimental market linkage facilities such as the ITS and the CSE System in providing a means to assure inter-market price protection for public limit orders, the Commission believes that certain aspects of the ITS and the CSE System deserve further attention. With respect to the operation of the ITS, The Commission understands that sometimes (particularly during periods of active trading) transactions are being effected in certain of the linked markets at prices inferior to the quotations disseminated by other linked exchanges. To some extent, this behavior may result from unfamiliarity of some brokers and exchange market makers with the use of ITS terminals; however, the continuation of this activity may also indicate that ITS procedures (particularly the length of time needed to enter a commitment to trade) are too slow to respond adequately to the needs of its users, or that additional self-regulatory organization or Commission rules may be required to ensure that better markets which are firm and readily accessible are not ignored.[35]

With respect to the CSE System, limited use of that System thus far has made it difficult for the Commission to evaluate the effects of trading in an electronic facility of this type. Although CSE System terminals are installed on the floors of the BSE, MSE and PSE, specialists have made little or no use of the System and virtually no agency orders have been entered through terminals on those exchanges except through a temporary arrangement

[32] Thus, price protection would be provided for all published bids and offers made available pursuant to Rule 11Acl–1 under the Act.

[33] Of course, even if price protection were provided for all displayed orders, it would be necessary to develop and implement a means of recalling and displaying electronically all limit orders away from the displayed quotation.

[34] Furthermore, this practice would result in the execution of a portion of an order at a price less favorable to the seller than he could otherwise have achieved unless the broker effecting the trade at 19¾, in addition to satisfying the public limit order at 19⅞, obtained an execution against the displayed bid of 20 by separately sending a commitment to trade through the ITS. *See* note 30 *supra*. Similar trading anomalies are possible in any limit order protection system which does not permit virtually instantaneous execution of limit orders between markets. *See* note 28 *supra*.

[35] Whatever reasons a member of a participating market center may have for failing to use the ITS to executie trades in a better market, the Commission believes that such behavior is unacceptable in an evolving national market system. *See also* note 30 *supra*. The causes for these failures should be identified by the appropriate self-regulatory organization and the reasons for not seeking better prices displayed by other market centers should be reported to the Commission by each ITS participant on a periodic basis.

between a single retail firm and one regional exchange specialist. In addition, although CSE rules permit retail firms to participate in the CSE System from their upstairs offices by becoming CSE approved dealers, only a few firms have thus far joined the System.

The Commission has indicated that the CSE System might provide the Commission with valuable insights into the benefits and difficulties of trading in an automated facility.[36] However, the data derived from the experience cannot be meaningful without significantly increased use of the facility. The Commission continues to believe that the CSE System offers a unique opportunity to study whether an automated trading facility can link various types of exchange based and upstairs broker-dealers in differing geographic locations. The Commission therefore urges those exchanges and broker-dealers not currently participating to consider doing so and if they consider that their analysis of the factors bearing on this decision useful to the Commission, to inform us, in writing, of their decision and the basis therefore.

3. Improvement of Quotation Information

Although there has been considerable effort on the part of the self-regulatory organizations and vendors to improve the quality of quotation information disseminated to broker-dealers and investors pursuant to Rule 11Ac1–1, further improvement in the timeliness and reliability of this information is necessary, especially if the concept of nation-wide price protection is to be extended to all displayed quotations.[37] Despite the steps taken by certain vendors to eliminate or reduce delays in the display of quotation information, the Commission remains concerned that general delays in the currency of quotation information will persist unless the vendors continue to upgrade their facilities to accommodate projected increases in the amount of trading volume and quotation information.[38] The Commission believes that each of the principal vendors of market information should commit themselves to the goal of displaying transaction and quotation information within a very few seconds after receipt.[39]

The Commission also is concerned that, during periods of active trading, revised quotations from certain exchanges (principally the NYSE) are not disseminated to vendors in a timely fashion. Whether these delays result from a failure on the part of specialists to promptly update their quotations or inefficiencies in exchange mechanisms and procedures for collecting and disseminating those quotations, the Commission expects the exchanges to take prompt action to correct this situation.[40]

Another improvement in the operation of the consolidated quotation system which the Commission expects to occur during the coming year is greater availability of quotation sizes which are identical to the quotation sizes available upon direct inquiry. Rule 11Ac1–1 does not currently require responsible brokers and dealers to communicate quotation sizes greater than a minimum unit of trading to their exchanges or association for dissemination to vendors. Instead, the Rule permits a responsible broker or dealer to communicate a quotation size greater than a minimum unit of trading and, in such event, that responsible broker or dealer must be firm up to the amount specified. The Commission understands that under this voluntary procedure there is often a disparity between the quotation size displayed by vendors and the size available upon inquiry. The Commission trusts that, as brokers and dealers gain familiarity with machine-displayed quotations, there will be less hesitancy and greater economic incentive to communicate actual quotation sizes, particularly if price protection is extended to all displayed quotations.

4. Broker to Market Center Order Routing Facilities

In the January Statement, the Commission called for the development of a

> Universally available message switch, permitting any broker or dealer to route orders for the purchase or sale of qualified securities from its offices to any qualified market trading in that security.[41]

In response to this request, the Commission received two somewhat inconsistent proposals.[42] Because of the varying scope of these principal proposals, particularly in terms of estimated implementation costs,[43] the Commission, in June 1978, solicited further comment on the basic policy question of whether order-by-order routing of retail orders to the market center disseminating the best quotation accompanied by a quotation size

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[36] *See* CSE System Approval, *supra* note 11, at 5, 43 FR at 17895; CSE System Extension, *supra* note 11, at 5, 44 FR at 130.

[37] Of course, improvement of the quality and timeliness of quotation information is necessary in order to refine that system whether or not price protection of all orders is determined to be an appropriate near term extension of that concept.

[38] Although the long delays previously experienced from August through mid-December 1978, have not continued, it is unclear to the Commission whether this results from the facilities enhancements made by vendors or the reduced volume in recent months.

[39] The Commission urges vendors to comment on the costs of achieving this goal and the technical problems, if any, inherent in its implementation.

[40] The NYSE has announced a program, to be completed during 1979, for the comprehensive upgrading of its floor trading facilities, including the replacement of the existing trading post with a completely redesigned structure containing certain communications enhancements. The Commission understands that the NYSE has not finally determined what facilities will be provided for the collection of last sale and quotation information as part of that upgrading program. The Commission believes that, whatever collection mechanism is ultimately selected, the NYSE program must provide facilities sufficient to assure that quotation and last sale information is made available to vendors within a very few seconds of their communication on the floor, even during periods of active trading.

[41] January Statement, *supra* note 1, at 29, 43 FR at 4358.

[42] The NYSE submitted a letter generally expressing support for enhancing order switching mechanisms but noting that a variety of such facilities, including its own common message switch, were currently available. The NYSE further noted that those switches commercially available from brokerage service firms currently permit brokers to route orders directly to the market of their choice. Notwithstanding its belief that a universal message switch is now functionally available, the NYSE expressed its willingness, later concurred in by the Amex, to provide other exchanges linkage to its message switch. However, the NYSE and Amex reserved judgment on the question of computer-to-computer interfaces with automated pricing and execution facilities such as PSE's COMEX and Phlx's PACE. *See* letter from James E. Buck, Secretary, NYSE, to George A. Fitzsimmons, Secretary, SEC, April 17, 1978, ("NYSE Order Routing Letter") and letter from Robert Birnbaum, President, Amex, to George A. Fitzsimmons, Secretary, SEC, April 24, 1978, ("Amex Letter") contained in File No. S7–735–A.

In contrast to this proposal, the NASD's Technical Plan described a national order routing system ("NORS") as a part of the overall national market system configuration. NORS would be designed to link all exchanes and third market makers with any broker-dealer desiring to send or receive messages through the system and would permit the routing of designated orders to a specific market center or undesignated orders on the basis of the best machine displayed quotation.

[43] The NYSE proposal appears premised upon the continued existence of multiple order routing mechanisms, so that the modified NYSE/Amex message switch would handle only a portion of message traffic. The NASD proposed NORS is based on the assumption that all orders would be routed through that facility, thus requiring significantly greater computer capacity.

equalling or exceeding the order in question (*i.e.*, the best market in size) should be a characteristic of the national market system.[44]

In response to its request, the Commission received comments from five self-regulatory organizations, the SIA, nine retail brokerage firms and one individual.[45] These commentators argued that order routing decisions should be made by the broker responsible for executing an order. Therefore, they opposed any Commission mandate to establish a single order routing facility which would eliminate broker discretion by forcing automatic routing of all orders on the basis of machine-displayed quotations. The commentators noted that such a system would virtually eliminate differences in execution services and competitive opportunities created by those differences. It was also argued that, in routing orders, brokers must consider many factors other than price, including the size of the order, execution and clearing costs,[46] perceptions as to the reliability of the displayed quotation (in terms of firmness and timeliness), and the likelihood of obtaining an execution at a price more favorable than that indicated by the displayed quotation.

The Commission continues to believe that a broker routing retail orders in a particular security to a single market (whether by automated or other means) must at least make periodic assessments of the quality of competing markets to assure that it is taking all reasonable steps under the circumstances to seek out best execution of customers' orders. For most brokers, the availability of a neutral order routing mechanism which would permit a firm easily to shift its order flow from one market center to another would facilitate compliance with this obligation.[47] The need for development of neutral order routing facilities is not, however, premised solely on the contribution such facilities would make to the ability of a broker to achieve "best execution" of his customers' orders. Development of order routing facilities which facilitate the routing of orders to any market center also will contribute to establishment of an environment satisfying the statutory objective of assuring fair competition among brokers and dealers and among markets.[48] If market makers in a particular market center have reasonable expectations that they will receive a greater amount of order flow if they make markets which are consistently better in terms of price, depth, or ease of execution, the Commission believes they will be more likely to compete aggressively—thereby providing a better and more efficient market. Order routing facilities currently offered to brokers by independent service firms do not appear to be inconsistent with the objective of assuring availability of neutral order routing facilities because brokers can contract for linkage through these facilities to any exchange of which they are a member or to any third market maker. The NYSE/Amex message switch, however, which currently only provides access to these exchanges, does not afford brokers a means of routing their orders to other market centers.

In its initial comment letter regarding the implementation of a universally available order routing mechanism, the NYSE stated that

> The [NYSE] agrees that there may be at least some demand for the message switch facility called for in the [January Statement]. In order to emphasize both its willingness to participate in the development of the national market system and its agreement that market share should be a function of market quality, the [NYSE] is prepared to undertake voluntarily the development of the called for message switch facility. The [NYSE] believes that this development can be most expeditiously achieved by adopting the present NYSE/AMEX switch so that it will have the capacity to perform "message routing" to and from broker-dealers and appropriate market centers. . . . The [NYSE] believes that modification of the NSYE/AMEX message switch facility as described above could be completed in three to six months following agreement on specifications and economic terms. . . .[49]

Modification of the NYSE/Amex message switch in the fashion contemplated by the NYSE will help assure achievement of the objectives underlying the commission's proposal to develop a universally available neutral order routing facility of the kind described in the January Statement. This modification will make it possible for participting members of the NYSE and Amex and other linked markets to choose among these markets, on a stock by stock basis, in determining where to route orders. The Commission understands that the NYSE, Amex and MSE currently are having discussions contemplating a change in the NYSE/Amex message switch that would permit that facility to be used for routing orders to and from the MSE. The Commission expects that the parties will continue these discussions and that a satisfactory agreement will be promptly reached. The Commission is requesting the NYSE, Amex and MSE to submit in the near future a status report to the Commission on these discussions specifying a timetable for inclusion of the MSE in the NYSE/Amex message switch. The Commission is also requesting that each other self-regulatory organization promptly advise the Commission (and the NYSE and Amex) whether it intends to seek linkage to the NYSE/Amex message switch. If any of these other self-regulatory organizations does not intend to seek this linkage, the Commission requests that it be promptly advised of the factors which influenced this decision.

On the basis of the NYSE/Amex offer to modify their message switch to permit all market centers desiring such linkage to send and receive messages through the system and the prospect of meaningful progress in the discussions with the MSE (and other market centers desiring linkage), the Commission is deferring consideration of such issues as whether order by order routing of retail orders to the best market in size should be required in a national market system. In the current trading environment, in which quotations are not firm under all circumstances, and there are practical limitations on access for execution purposes and differences in clearing costs,[50] it is questionable whether individualized routing of all orders on the basis of machine-displayed quotations should be required. Indeed, enhanced market linkage systems may diminish the need to develop a system capable of order by order routing from upstairs offices to all market centers at least from the standpoint of assuring satisfaction of a broker's best execution responsibility.[51] The Commission, however, will continue to consider the feasibility and necessity of requiring the implementation of a more comprehensive facility in the light of

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[44] *See* Securities Exchange Act Release No. 14885 (June 23, 1978), 15 S.E.C. Doc. 138.

[45] All of these comments are contained in File NO. S7–735–A.

[46] *See* text *infra* at notes 55–56.

[47] The legislative history of the 1975 Amendments specifically notes that the use of routing systems which are designed to route orders to only one market center is "inconsistent with the development and operation of a national market system. It may also be inconsistent with a broker's obligation to obtain 'best execution' for his customers. The subsection would accordingly give the SEC the responsibility to require brokers to utilize order 'switching' services which are 'neutral' as to market centers, giving preference to one execution facility over another only to insure best execution." Senate Report, *supra* note 3, at 104–05, [1975] U.S. Code Cong. & Ad. News at 282.

[48] *See* Section 11A(a)(1)(C)(ii) of the Act and text *infra* following note 64.

[49] NYSE Order Routing Letter, *supra* note 42, at 15–17. The Amex concurred in this statement in its comment letter. *See* Amex Letter, *supra* note 42, at 3.

[50] *See* text *infra* at notes 55–56.

[51] *See* text *supra* at notes 18–36.

subsequent developments in the structure of the securities markets.

4. Off-Board Trading Restrictions

In its January Statement, the Commission announced that it was deferring its consideration of the need to remove all remaining exchange offboard trading restrictions in order to evaluate industry and self-regulatory organization responses to the national market system initiatives announced in that Statement.[52] Notwithstanding that determination to defer consideration of removal of off-board trading restrictions as they apply to securities which are now listed, the Commission believes that many of the arguments raised by commentators in support of retaining these restrictions, even if accurate as to securities which are currently traded primarily in an exchange environment, may not be applicable to or warrant extension of these rules to securities which are currently traded exclusively over-the-counter.[53] Thus, the Commission is concerned that future extension of off-board trading restrictions to securities now traded exclusively over-the-counter upon their initial exchange listing may not be justified under the Act. Therefore, the Commission will commence a rulemaking proceeding to consider whether to preclude the application of off-board trading restrictions to securities not previously subject to those restrictions.

The Commission continues to believe that, in areas involving potentially profound market structure change, such as the elimination of remaining off-board trading restrictions, use of controlled, limited experiments may be both prudent and instructive. In addition, a proposal of this type could permit over-the-counter market makers to experience a trading environment in which last sale and quotation information is made available on a real time basis.

Additional Issues

In addition to the foregoing initiatives, the Commission also expects to explore certain related market structure issues during 1979.

1. Qualified Securities

In the January Statement, the Commission stated that it proposed to initiate a proceeding for the purpose of designating certain categories of securities as qualified for trading in the national market system.[54] In response to this announcement, the Commission received proposals and comments from the NASD, the National Securities Traders Association and the National Association of OTC Companies which generally cautioned the Commission that premature inclusion of unlisted securities into certain national market system facilities would have undesirable effects on the existing markets for those securities. The Commission is still in the process of formulating a regulatory proposal regarding the designation of qualified securities. Among the issues which the Commission is considering are the particular standards to be used to designate securities and the timing of inclusion of those securities in national market system facilities. The Commission must resolve (i) whether those standards should be uniform for listed and over-the-counter securities; (ii) whether financial criteria concerning the issuer and data with respect to the number of shareholders or trading characteristics, such as volume and the extent of multiple trading, are relevant criteria for designing standards; (iii) whether such standards should be completely objective or whether they should be subject to administrative discretion and, if so, who should be responsible for applying these standards; and (iv) whether the issuer should have a role in the selection process. The Commission shares the concerns expressed by commentators regarding the effects of premature incorporation of qualified securities into national market system facilities. In this regard, the Commission will consider whether designation should result in immediate inclusion in one or more facilities (such as the consolidated transaction reporting and quotation systems) prior to inclusion in other facilities or whether designation should require inclusion in all national market system facilities, but should await more complete evolution of the system.

2. National System for Clearance and Settlement

During the coming year, the Commission will continue to work toward full implementation of a national clearance and settlement system having as its foundation the minimum capabilities proposed by the Commission in January 1977.[55] Perhaps the most important of those characteristics, in terms of its effect on the Commission's initiatives to facilitate the establishment of the national market system, is "one-account processing." One-account processing enables a participant to compare, clear and settle, through single accounts with a clearing agency and with a depository, all trades in securities included in the system regardless of the location of the other party to the trade or the market in which the trade is executed. That capability, in addition to its impact on the efficiency of clearing procedures, is essential to enable a broker-dealer to seek the best price available without concern that his choice of market of execution will result in materially increased clearance and settlement costs.

The development and expansion of interfaces during the past year, particularly the establishment of regional interfaces for the processing of over-the-counter transactions, has made one-account processing almost universally available. The Commission will seek during the coming year to complete that process so that all broker-dealers and financial institutions participating in the national clearance and settlement system have one-account processing.

In addition, the Commission intends to direct its attention to three other areas which will substantially affect the national market system.[56]

i. Branch Offices amd Remote Terminals. Clearing agency branch offices or remote terminal provide broker-dealers throughout the country with access to the national clearance and settlement system without the necessity of physical presence in the

[52] January Statement, *supra* note 1, at 38–39, 43 FR at 4360. *See* Securities Exchange Act Release No. 13662 (June 23, 1977), 42 FR 33510. The Commission did, however, state: " [T] he Commission does not wish its determination to defer consideration of proposed rule 19c–2 at this time to be perceived as indicating that the Commission is willing to postpone removal of offboard trading restrictions indefinitely or until further progress has been made toward implementation of any particular additional element of a national market system. To the contrary, the Commission has repeatedly expressed the view that the present restrictions must ultimately be eliminated, and remains concerned that retention of those restrictions, in addition to impeding competition, may retard achievement of a national market system." January Statement, *supra* note 1, at 39–40, 43 FR at 4360. *See also* Securities Exchange Act Release No. 15378 (December 1, 1978) ("Amex Order"), at 9–10, 43 FR 58684, 58686.

[53] Although this issue was raised collaterally in connection with the Commission's recent approval of revised Amex listing standards, the Commission determined, in that limited context, not to address the general question of application of off-board trading restrictions to securities now traded exclusively in the over-the-counter market. *See* Amex Order, *Supra* note 52.

[54] January Statement, *supra* note 1, at 45–46, 43 FR at 4360–61.

[55] The Commission has set forth six standards which, in its view, the national clearance and settlement system should meet in order "to satisfy the requirements of Section 17A of the Act and other concerns affected by the operation of [the system]." Securities Exchange Act Release No. 13163 (January 13, 1977), at 21, 42 FR 3916, 3920.

[56] Although the Commission will be undertaking other initiatives in developing the national clearance and settlement system, the following developments are viewed as having the most direct effect on the national market system.

principal clearing centers. The establishment of regional centers will permit each participant broker-dealer or financial institution to clear through the entity of its choice without regard to its own physical location or that of the clearing agency. Thus, in conjunction with one-account processing, a participant in the national clearance and settlement system may select any clearing agency and may clear and settle transactions with that entity effected from any market center.

ii. Pricing of Services. As previously announced, the Commission intends to initiate a proceeding to consider issues associated with interface fees or charges which function as interface fees. These charges make it more expensive for a broker-dealer to clear and settle a transaction executed in a market other than the market affiliated with his clearing agency. In the context of this proceeding, the Commission must explore whether these charges would in fact affect the participant's choice of markets. In addition, the United States Court of Appeals for the District of Columbia Circuit has remanded to the Commission for further consideration the use of geographic price mutualization by the National Securities Clearing Corporation ("NSCC").[57] This pricing mechanism, which enables NSCC to provide services to all its participants at an equal price regardless of geographic location, was deemed by the Commission to have an important impact on competition among broker-dealers and, pursuant to the discussion of the Court of Appeals, must be reconsidered during the coming year.[58]

iii. Expansion of the System. During the next year the Commission will continue to encourage clearing agencies and depositories to include in their processing activities all securities which are suitable for inclusion in the system. In addition, we will continue to encourage all broker-dealers and financial institutions to participate directly or indirectly in the national clearance and settlement system in order to reduce the physical movement of securities, increase the efficiency of the national clearance and settlement system, and otherwise advance the Congressional objectives set forth in the Act.

3. Options

The Commission has recently released a staff report on its Special Study on the Options Markets ("Options Study")[59] and issued a release setting forth the Commission's views regarding the recommendations contained in the Options Study as well as a proposed timetable for ending the so-called options moratorium.[60] The Options Study addresses a number of important market structure issues and contains a detailed discussion of certain questions arising from the mulitiple trading of standardized options and the steps that the Commission might consider to assure that options markets evolve in a manner which is consistent with the Act, particularly the Congressional mandate to facilitate the establishment of a national market system for securities. More specifically, the Options Study suggests an analytical framework for evaluation of options market structure questions, such as (i) the necessity of implementing market linkage and centralized limit order facilities, (ii) the effects of current brokerage firm option order routing procedures, (iii) the feasibility and desirability of collecting and disseminating "firm" quotations for standardized options and (iv) the effects of off-board trading restrictions on the options markets. During the next year the Commission and the industry must explore and hopefully resolve many of these questions. The Commission urges the self-regulatory organizations to begin a joint effort to develop a national market subsystem for options which is compatible with and complementary to the national market system for stocks.[61]

4. Surveillance

One potential benefit to be derived from the increased use of technology in the national market system and other contexts is the enhanced ability of computer systems to assist in establishing and maintaining proper audit trails and in surveilling trading in the nation's securities markets. Because the Act imposes primary surveillance responsibility on the various self-regulatory organizations, the Commission believes that these entities must begin to employ today's enhanced technology, including that used in national market system facilities, to ensure improvement of their surveillance capabilities in accordance with the Act. As trading in multiple physical locations becomes increasingly integrated, and as the existence of derivative securities such as put and call options creates novel forms of trading activity, surveillance systems must be designed to detect improprieties in a significantly more complex environment. The exchanges and the NASD must take these factors into account in meeting their statutory surveillance responsibilities and must find ways of sharing necessary data and jointly formulating surveillance mechanisms in order to accomplish these ends.[62] The Commission continues to believe that all aspects of the national market system, including surveillance, must be planned and developed in tandem to assure that new types of trading facilities do not present the opportunity for undersirable or manipulative activities which may not be adequately monitored.[63]

Conclusion

The past fourteen months have been a period of significant accomplishment in the development of a national market system. The consolidated quotation system, long considered an essential part of the national market system, has been implemented and the ITS and CSE System pilot programs are permitting experimentation with actual market linkage and electronically assisted trading mechanisms which have been advocated as possible means of achieving the somewhat conflicting objectives set forth in Section 11A of the Act.[64] Although each of these facilities needs refinement and continued assessment in the light of operating experience and changing economic and regulatory concerns, their intitial implementation must be seen as a significant first step. Additionally, through the January Statement and the responsive commentary, during the past year the Commission and industry have had an opportunity to consider a variety

[57] Bradford Nat'l Clearing Corp. v. SEC, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,553, at 94,281 (D.C. Cir., Nos. 77-1199 & 77-1547, Sept. 1978).

[58] *See* Securities Exchange Act Release No. 13163, (January 13, 1977), *supra* note 55, at 76-79, 42 FR at 3930-31.

[59] SEC, Report of the Special Study of the Options Markets (1979). The Options Study was made publicly available on February 15, 1979. *See* Securities Exchange Act Release No. 15569 (February 15, 1979), SEC News Digest No. 79-33, at 3.

[60] *See* Securities Exchange Act Release No. 15575 (February 22, 1979), 44 FR 11867.

[61] *See generally*, Options Study, *supra* note 59, Chapter VIII, Issues of Structure in the Standardized Options Markets at 257-72.

[62] In this regard, the Commission believes that the recent efforts of the Amex, BSE, CBOE, MSE, NYSE, NASD, PSE, Phlx and the Options Clearing Corporation to integrate surveillance and regulatory systems and data, particularly with respect to options trading, reflects the proper direction and that such efforts should continue.

[63] In fulfillment of its responsibility to assure proper self-regulatory organization surveillance and to better enforce those aspects of the securities laws under its direct regulation, the Commission has engaged consultants to review the adequacy of existing surveillance systems, and make recommendations for enhancing Commission surveillance capability to complement that of the self-regulatory organizations. *See* SEC News Release No. 78-23 (July 28, 1978).

[64] *See* Securities Exchange Act Release Nos. 13662 (June 23, 1977), at 22-23, 42 FR 33510, 33512-14, and 11942 (December 19, 1975), at 10-11, 41 FR 4507, 4510.

of alternative national market system configurations.

In this release the Commission has set forth an updated national market system program which attempts to be responsive to the progress made and the commentary it has received during the past year while remaining consistent with objectives set forth in Section 11A(a) of the Act. We believe that the consolidated transaction reporting and quotation systems, comprehensive market linkage systems and nation-wide price protection for public limit orders will achieve certain of these Congressional objectives. However, we remain concerned that, while addressing the disclosure and market fragmentation issues raised by the Congress, the implementation of these facilities alone may not fully address the need for providing a fair field of competition among brokers and dealers and among markets [65] and thereby ultimately fail to assure that customers receive the best execution of their orders. For example, continuation of the practice of most large brokerage firms of automatically routing retail size orders to purchase or sell multiply-traded securities to the "primary" market for the security may preclude effective competition among markets despite the existence and enhancement of market linkage systems. Since it may not be possible to realize all of the objectives set forth in Section 11A of the Act at the same time or to envision a point in time after which the Commission and the securities industry will be able to state that all of these objectives have been permanently secured, the Commission believes that it must guard against a course of action which sacrifices one or more of these objectives in order to achieve others. In this light, the Commission intends to reassess its efforts and those of the industry on a continuing basis in order to assure that there is an opportunity for fair competition in the securities markets and specifically requests comment on the effectiveness of the proposals contained in this release in achieving this goal.

While the initiatives proposed in this status report represent the Commission's views after consideration of the progress made during 1978 and the many comments received in response to the January Statement, the Commission remains receptive to alternative suggestions, particularly alternative ways of achieving the goals articulated herein and encourages interested persons to submit commentary on any of the Commission's views expressed in this release. Comments should be addressed to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, Room 892, 500 North Capitol Street, Washington, D.C. 20549. All comments should refer to File No. S–735–A and will be available for public inspection at the Commission's Public Reference Room, Room 6101, 1100 L Street, N.W., Washington, D.C.

By the Commission.

George A. Fitzsimmons

Secretary.

March 22, 1979.

[Release No. 34–15871; File No. S7–735–A]

[FR Doc. 79–10104 Filed 4–3–79; 8:45 am]

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[65] Section 11A(a)(1)(C)(ii) states that one objective of the national market system is "fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets."

federal register

Wednesday
April 4, 1979

Part VI:

Environmental Protection Agency

General Preamble for Proposed Rulemaking on Approval of State Implementation Plan Revisions for Nonattainment Areas

ENVIRONMENTAL PROTECTION AGENCY

[40 CFR Part 52]

State Implementation Plans; General Preamble for Proposed Rulemaking on Approval of Plan Revisions for Nonattainment Areas

AGENCY: Environmental Protection Agency.

ACTION: General preamble for proposed rulemaking.

SUMMARY: Provisions of the Clean Air Act enacted in 1977 require states to revise their State Implementation Plans for all areas that have not attained National Ambient Air Quality Standards. States are to have submitted the necessary plan revisions to EPA by January 1, 1979. During the next several months, EPA will be publishing proposals inviting public comment on whether each of the submittals should be approved. This General Preamble supplements these proposals by identifying the major considerations that will guide EPA's evaluation of the submittals.

COMMENTS: As State plan submittals are received, EPA Regional Administrators will publish **Federal Register** proposals inviting comment on whether the submittals should be approved. Even before the formal EPA proposal is published, in some instances Regional Administrators are publishing notices announcing receipt of SIP submittals, and availability of the submittals for public inspection. Each proposal or other notice inviting comment will state the address and closing date for submittal of comments to the appropriate EPA Regional Office.

For Further Information Contact the Appropriate EPA Regional or Headquarters Office

Betsy Horne, Air Branch, EPA Region I, JFK Federal Building, Boston, Mass. 02203, (617) 223–4448 (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont).

William S. Baker, Chief, Air Programs Branch, EPA Region II, 26 Federal Plaza, New York, N.Y. 10007, (212) 264–2517 (New York, New Jersey, Puerto Rico, Virgin Islands).

Howard Heim, Chief, Air Programs Branch, EPA Region III, Curtis Building, Sixth and Walnut Streets, Philadelphia, Pa. 19106, (215) 597–8175 (Delaware, Maryland, Pennsylvania, Virginia, West Virginia, District of Columbia).

Walter H. Bishop, Air Programs Branch, EPA Region IV, 345 Courtland Street, N.E., Atlanta, Ga. 30308, (404) 881–3286 (Alabama, Georgia, Florida, Kentucky, Mississippi, North Carolina, Tennessee, South Carolina).

Debra Costello, Air Programs Branch, EPA Region V, 230 South Dearborn Street, Chicago, Ill. 60604, (312) 353–2205 (Indiana, Illinois, Michigan, Minnesota, Ohio, Wisconsin).

Jerry Stubberfield, Chief, SIP Section, Air Programs Branch, EPA Region VI, 1201 Elm Street, Dallas, Tex. 75270, (214) 767–2742 (Arkansas, Louisiana, Oklahoma, New Mexico, Texas).

William Spratlin, Chief, Air Support Branch, EPA Region VII, 324 East 11th Street, Kansas City, Mo. 64106, (816) 374–3791 (Nebraska, Iowa, Kansas, Missouri).

Robert DeSpain, Chief, Air Branch, EPA Region VIII, 1860 Lincoln Street, Denver, Colo. 80295, (303) 837–3471 (Montana, Utah, North Dakota, South Dakota, Wyoming, Colorado).

Douglas Grano, Chief, Regulatory Section, Air Technical Branch, EPA Region IX, 215 Fremont Street, San Francisco, Calif. 94105, (415) 556–2938 (California, Nevada, Arizona, Hawaii, American Samoa, Guam, Northern Mariana Islands).

Clark Gaulding, Chief, Air Programs Branch, EPA Region X, 1200 Sixth Avenue, Seattle, Wash. 98101, (206) 442–1230 (Alaska, Washington, Oregon, Idaho).

G. T. Helms, Chief, Control Programs Operations Branch, Control Programs Development Division, EPA Office of Air Quality Planning and Standards (MD–15), Research Triangle Park, North Carolina 27711, (919) 541–5365 or 541–5226 (Headquarters).

SUPPLEMENTARY INFORMATION:

Outline

I. Background

In the 1970 amendments to the Clean Air Act,[1] Congress directed EPA to establish primary National Ambient Air Quality Standards (NAAQS) to protect the public health, and secondary NAAQS to protect the public welfare, and directed the states to develop and adopt State Implementation Plans (SIPs) to attain and maintain the standards. EPA was given responsibility for reviewing SIPs and either approving them, or disapproving them and promulgating substitutes.

In 1971 EPA promulgated NAAQS for sulfur oxides, particulate matter, carbon monoxide, ozone (originally called photochemical oxidants), and nitrogen dioxide.[2] SIPs were developed and placed into effect. To meet statutory deadlines, the NAAQS were to have been attained in most regions by 1975, with some extensions until 1977.

By 1976 it became apparent that, despite significant progress, SIPs were inadequate to achieve the NAAQS in many areas of the country. EPA therefore issued numerous calls for states to revise their SIPs to provide for attainment. Questions also arose as to whether, and under what circumstances, new stationary sources might legally be permitted to construct in areas where the NAAQS were not being met. In response to these questions, EPA published its Emission Offset Interpretative Ruling,[3] which allowed new construction in areas where NAAQS were violated as long as stringent conditions were met that would assure further progress toward attainment of the standards.

In August 1977 Congress amended the Act to (among other things) establish a statutory approach to permit growth in polluted areas, while requiring attainment of the NAAQS by specific deadlines.[4] Congress first instructed

[1] The Clean Air Act, as amended, is codified at 42 U.S.C. 7401 *et seq.*

[2] 40 CFR Part 50. EPA also promulgated a hydrocarbons standard "for use as a guide in devising implementation plans to achieve oxidant standards." 40 CFR 50.10. On October 5, 1978, EPA published an NAAQS for lead. 40 CFR 50.12, as added 43 FR 46258. However, Part D of the Act (discussed in the text below) does not require SIP submittals now due to implement the lead standard. The requirements that now govern lead SIPs were promulgated along with the standard. 40 CFR Part 51, as amended 43 FR 46269.

[3] Originally promulgated on December 21, 1976, the Ruling was recently revised. 40 CFR Part 51, Appendix S, as revised 44 FR 3274 (January 16, 1979).

[4] Sections 107(d) and 172 of the Act (42 U.S.C. 7407(d) and 7502); sections 129 (a) and (c) of the

Footnotes continued on next page

each state to list those areas where NAAQS were still not attained as of August 7, 1977 (nonattainment areas), and instructed EPA to promulgate the list with any necessary changes. Each state then had to submit a SIP revision by January 1, 1979, providing for attainment of the NAAQS as expeditiously as practicable, and for primary standards no later than the end of 1982 (or the end of 1987 for areas with particularly difficult ozone or carbon monoxide problems). Congress also provided that EPA's Offset Ruling would govern new source construction until July 1, 1979, after which date proposed major sources are to be reviewed under the provisions of a revised SIP that meets the requirements of Part D.[5]

A list of nonattainment areas was promulgated on March 3, 1978, with some subsequent modification, and for these areas states are now in the process of submitting adopted SIP revisions to EPA for approval.[6] During the next several months, EPA will be publishing proposals soliciting public comment on whether each of the submittals should be approved. This General Preamble supplements these proposals, by identifying the major considerations that are guiding EPA's evaluation of the submittals.

The fundmental requirements for approval of SIPs are set out in Title I of the Clean Air Act, and in EPA's regulations at 40 CFR Part 51. On February 24, 1978, the Administrator of EPA issued a memorandum summarizing the elements that an approved SIP must contain by July 1, 1979, to satisfy the Act's requirements for nonattainment areas. The Agency has also prepared guidance on how to satisfy these basic requirements, and clarifying the requirements where necessary.[7]

Footnotes continued from last page
1977 Amendments, Pub. L. No. 95-95 (notes under 42 U.S.C. 7502).

[5] There are some circumstances under which the Offset Ruling will still apply. *See* note 36 below.

[6] EPA promulgated intitial designations and invited public comment. 43 FR 8962 (March 3, 1978). In response to the comment received, EPA modified the designations in certain areas of the country, and is in the process of modifying designations in some additional areas. 43 FR 40412 (September 11, 1978) (EPA Regions I, IV, VI, VIII, X); 43 FR 40502 (September 12, 1978) (EPA Region III); 43 FR 45993 (October 5, 1978) (EPA Region V); 44 FR 5119 (January 25, 1979) (EPA Region II).

[7] Title I of the Act is codified at 42 U.S.C. Chap. 85, Subchap. I. The sections most relevant to this General Preamble, sections 107 through 128 and 171 through 176 of the Act, are codified at sections 7407 through 7428 and 7501 through 7506, respectively, of 42 U.S.C. The Administrator's memorandum on criteria for approval was reproduced in the **Federal Register** at 43 FR 21673 (May 19, 1978). The guidance material has been collected together for public inspection, and a notice of availability was published at 44 FR 8311 (February 9, 1979).

The purpose of this General Preamble is to summarize the principal requirements, in order to assist the public in preparing comments on the approvability of the submittals. However, there are additional, more detailed requirements and explanations in the statute, regulations, and guidance, which interested parties may consult in preparing comments.

For each nonattainment SIP submittal EPA must make two decisions: whether each individual element of the submittal should be approved as a revision to the SIP; and whether the revised SIP, as a whole, satisfies the requirements of Part D of Title I of the Clean Air Act. In addition, EPA must review the revised SIP as soon as possible to determine whether it satisfies all other pertinent, non-Part D requirements of the Act.

II. Approval of Individual SIP Elements

The effect of approving each element of a submittal as a SIP revision is to add to or alter the "applicable implementation plan"—that is, the collection of SIP provisions approved or promulgated by EPA and enforceable under federal law (*see* sections 110(d) and 113(a) of the Act). Even if EPA accepts the entire SIP submittal, EPA may find that the overall revised SIP is inadequate because it did not go far enough. If a submittal does not accomplish enough, EPA will ordinarily approve the submitted SIP elements that are acceptable, but will disapprove the SIP in part, to the extent that more provisions are needed.

A. *Basic Requirements*

The 1977 Amendments to the Act did not alter the principles governing revisions to the applicable implementation plan. The basic criteria for approving any individual element of a submitted plan revision, under section 110(a)(3)(A) of the Act, are that it must—

- Be legally adopted by the state.
- Be adopted after reasonable notice and public hearing by the state.[8]
- Be enforceable.
- Not interfere with assuring attainment and maintenance of the NAAQS by the required deadline, or with satisfying the Act's other requirements.

B. *Further Guidance*

1. *Enforceability.* In determining whether a SIP provision is enforceable, emission limitations and other requirements will be reviewed for clarity and specificity. Emission limitations and other controlling terms must be well defined, and must clearly state which sources and processes are being regulated, when the required actions are to be taken and by whom, and what specifically is to be done. In addition, the provision must specify any necessary test method by which compliance is to be assessed, and, if the provision requires compliance at a future date, it must contain an adequate schedule for compliance.

2. *Stringency.* It is EPA's policy to encourage and assist states in adopting economically efficient pollution control methods.[9] However, the Agency has no authority under the Act to reject a requirement adopted by a state because it is too costly or too stringent.[10] ("Stringency" refers to both the controls required and how quickly they must be implemented.) However, EPA must reject any individual requirement that would interfere with attaining and maintaining the NAAQS by the required deadline or with achieving the other requirements of the Act.[11]

3. *Relaxation or Revocation.* Even when a new requirement is being added to a SIP, the existing requirement may not ordinarily be relaxed or revoked. The new requirement does not

[8] Notice and hearing are required for all SIP revisions except non-regulatory revisions that are so insignificant that they will not affect the program for attainment or maintenance of the NAAQS. *See* 40 FR 28629 col. 2, 28631 col. 2 (July 8, 1975).

[9] For example, EPA encourages states to consider allowing plants to place less control on processes where the marginal cost of control is high, in return for placing greater control where cost is low, so that the total control satisfies SIP requirements. *See* note 16 below on alternative emission reduction ("bubble") options; Preamble to Emissions Offset Interpretative Ruling, 44 Fed. Reg. 3274, 3276 col. 3 (January 16, 1979); discussion in section III.B.1 of the text below, on *Need for All RACM.*

[10] Therefore, EPA may not disapprove a requirement on the ground that it is costly or even economically or technologically infeasible, or on the ground that the overall plan is more stringent than federal law requires. *See* Union Electric Company v. EPA, 427 U.S. 246, 265 (1976). Of course, to the extent even full efforts to implement and enforce a measure cannot bring about the emission reductions called for, EPA may deny credit for those reductions in demonstrations of reasonable further progress and attainment, or may reject the measure as unenforceable. For example, a submitted provision calling for an alteration of transportation patterns that simply cannot be achieved may be denied credit or rejected.

[11] For example, a submitted emission limitation would have to be rejected if a more stringent emission limitation is needed under the Act and if application of technology *to meet the submitted emission limitation would make application of technology to meet the needed emission limitation more difficult.* Likewise, a relatively slow schedule for implementation of inspection/maintenance must be rejected to the extent that a more expeditious schedule is required under the Act (*see* section III.B.4 in the text below, on *Inspection/Maintenance).* As discussed in section III.B.1 of the text below, on *Need for All RACM,* states often have flexibility to obtain more or less emission reduction from any one measure, as long as a group of measures in the plan is adequate. Therefore, review of an individual requirement to determine whether it will interfere with attainment of the NAAQS and other Act requirements must often be conducted together with review of the entire SIP to determine whether it is adequate overall.

supersede or replace the old requirement until the source comes into compliance with the new requirement. Instead, the existing requirement must remain an enforceable provision of the SIP, and must co-exist with the new requirement in the applicable implementation plan. The present emission control requirement must be retained because the source must be prevented from operating without controls (or with less stringent controls) while it is moving toward compliance with (or challenging) the new requirement.[12]

There are some exceptions, however. A state may submit a relaxation or revocation of an existing requirement (or, for an existing requirement promulgated by EPA, have EPA relax or revoke it), if the requirement is in one or more of the following categories:

(a) Any existing requirement that conflicts with a new, more stringent requirement, making it highly impratical for a source to comply with the old requirement.[13] Any exemption granted must be drawn as narrowly as possible.

(b) Any indirect source review program revocable under section 110(a)(5)(A)(iii) of the Act,[14] and any bridge toll requirement revocable under section 110(c)(5)(A) of the Act.

(c) Any existing inspection/maintenance or transportation control measure, to the extent the measure is demonstrated not to be reasonably available, if the revised SIP satisfies all Part D requirements (Part D requirements are discussed in section III below).[15]

(d) Any new requirement in a 1979 SIP submittal designed for the 0.08 ozone level, as long as the control measures in the revised SIP satisfy all requirements for the 0.12 level (as discussed in section III.B.6 below, on *Ozone Standard*).

A relaxation or revocation is also premissible if it will not contribute to concentrations of pollution where there is a violation of a NAAQS or of a Prevention of Significant Air Quality Deterioration (PSD) increment.[16] Where relaxation of a requirement is allowed, but where the deadline for compliance is not relaxed, the new requirement must call for compliance no later than the existing deadline for compliance, so that there is no gap in enforceability.

Any submitted relaxation or elimination of an existing requirement that does not fall within one of these permissible categories may be disapproved by EPA. A disapproved submittal will not affect the federal enforceability of the existing requirement in the applicable implementation plan.

III. Approval of Revised SIP as Satisfying Part D Requirements

The second major question that EPA must address is whether the revised applicable implementation plan satisfies the requirements of Part D of Title I of the Act. This is a critical determination under the Act, because, for nonattainment areas, there is to be major source construction under permits applied for after June 30 , 1979, unless the approved SIP satisfies Part D requirements. Furthermore, certain federal highway and air pollution control program grants are to be withheld if EPA finds after July 1, 1979 that the SIP submittal does not consider all Part D requirements or reasonable efforts toward submitting such a SIP submittal are not being made.[17]

A. *Basic Requirements.*

The following are, in general terms, the requirements a plan must meet to satisfy Part D. After each item is a citation to the applicable section of the Act and the applicable paragraphs of the Administrator's February 24, 1978

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[12] If existing requirements could be relaxed or superseded, recalcitrant sources could be relieved of obligations established under the Act preceding the 1977 Amendments. However, the 1977 Amendments were intended to provide additional time for additional controls to be applied, not to permit relaxation of existing requirements. Therefore, failure of a source to meet applicable existing requirements is subject to appropriate enforcement action, including assessment of noncompliance penalties. Furthermore, if there is any instance of delay or lapse in the applicability or enforceability of the new requirements, because of a court order or for any other reason, the existing requirements will be applicable and enforceable.

[13] For example, equipment needed to satisfy existing requirements may have to be disconnected before more efficient equipment needed to satisfy new requirements under the 1977 Amendments can be installed. In such a situation, the existing requirement may be suspended insofar as necessary to permit installation of the more efficient equipment.

[14] EPA's interpretation of this provision is published at 44 FR 5427 (January 26, 1979).

[15] "Inspection/maintenance" programs are measures providing for emission-control inspection and maintenance of motor vehicles. "Transportation control" measures are measures directed toward reducing emissions of air pollutants from transportation sources. Although some early transportation control plans included various stationary source control measures (such as vapor recovery from filling of vehicular tanks or other storage containers, control of degreasing and surface coating activities, and others (*see, e.g.*, 38 Fed. Reg. 31232 (November 12, 1973)), these stationary source control measures are not transportation control measures.

See the discussion in section III.B.5 of the text below, on reasonable availability. To the extent deadlines for compliance are not practicable, they may be relaxed. The fact that a measure has actually been implemented will ordinarily indicate that the measure is reasonably available and the deadlines are practicable. As explained in section III.B.4 of the text below (on *Inspection/Maintenance*) a revised SIP with an attainment date after 1982 must meet certain minimum requirements for inspection/maintenance.

In 1973 EPA promulgated inspection/maintenance and transportation control measures for numerous areas of the country, including requirements that states implement the measures. Several states sought judicial review of EPA's authority to promulgate these requirements. The courts of appeals reached inconsistent decisions, and the Supreme Court has not resolved the issue. Pennsylvania v. EPA, 500 F.2d 246, 257, 261 (3d Cir. 1974); Maryland v. EPA, 530 F.2d 215, 226–27 (4th Cir. 1975); Brown v. EPA, 521 F.2d 827, 831 (9th Cir. 1975); District of Columbia v. Train, 521 F.2d 971, 986 (D.C. Cir. 1975). All except the *Pennsylvania* case were *vacated and remanded sub nom.* EPA v. Brown, 431 U.S. 99 (1977). *On remand,* Brown v. EPA, 566 F.2d 665 (9th Cir. 1977); Maryland v. EPA, Nos. 74–1007 et al. (4th Cir., filed October 13, 1977); District of Columbia v. Costle, 567 F.2d 1091 (D.C. Cir. 1977).

Under the most recent D.C. Circuit decision, EPA must conduct substantial additional rulemaking proceedings before the regulations will be ready for further judicial consideration. However, rulemaking over the past year and a half after D.C. Circuit decision would have distracted the states, EPA, and interested members of the public from devoting their full efforts and attention to development of the plan revisions now due, including any necessary inspection/maintenance and transportation control measures. The Agency therefore decided not to proceed for the time being with the litigation and related administrative proceedings involving the 1973 regulations.

However, EPA still believes that the Clean Air Act provides a basis for promulgating enforceable transportation control measures requiring state implementation. The Agency has therefore not altered its enforcement policy for the 1973 regulations that are not subject to judicial review. After the 1979 SIP revisions have been submitted and evaluated, EPA will reconsider what further proceedings on the 1973 regulations are necessary, if any.

[16] PSD increments are the amounts of deterioration of air quality better than the NAAQS that is permitted under section 163 of the Act (42 U.S.C. 7473) and 40 CFR 51.24, 52.21, as revised 43 FR 26380, 26388 (June 19, 1978).

Under EPA's Alternative Emission Reduction ("Bubble") proposal, controls for individual processes within a plant may be relaxed if alternative control requirements are applied so that total plant emissions do not increase and other requirements are met. *See* Memorandum from the Administrator of EPA to Directors of State Air Programs, on "Implementing The Alternative Emission Reduction ('Bubble') Approach" (December 21, 1978); Proposed Policy Statement on Alternative Emission Reduction Options Within State Implementation Plans, 44 FR 3740 (January 18, 1979).

[17] The "requirements of Part D" are the requirements of sections 110(a)(3)(D), 110(c)(5)(B), and 171–174 of the Act. (The requirements of sections 110(a)(3)(D) and 110(c)(5)(B) are to be treated as requirements of Part D, even though these sections are not physically within Part D of Title I of the Act.) These restrictions on construction, grants, and funds where SIPs are inadequate are found in sections 110(a)(2)(I), 113(a)(5), and 176(a) of the Act. Even if the SIP itself is adequate, failure to implement and carry out the SIP will result in withholding of new source permits and air pollution control program grants, under sections 173(4), 113(a)(5), and 176(b) of the Act. In addition, section 316 of the Act (42 U.S.C. 7616) provides that the Administrator may withhold, condition or restrict sewage treatment plant construction grants if he determines that the air emissions reasonably anticipated to result from the growth associated with the expanded sewage treatment capacity is not being adequately anticipated and compensated for under the SIP.

memorandum on Criteria for Approval of 1979 SIP Revisions:[18]

1. *Requirements for All Part D SIPs:*

● Demonstrate that both primary and secondary NAAQS will be attained within the nonattainment area as expeditiously as practicable, but for primary NAAQS no late than the following final deadlines: (§ 172(a); ¶¶ 1, 3, 5.)

—For sulfur oxides, particulate matter, and nitrogen dioxide, December 31, 1982.

—For ozone or carbon monoxide, December 31, 1982, except, if the state demonstrates that attainment by December 31, 1982 is impossible despite implementation of all reasonably available measures, December 31, 1987.

● Require reasonable further progress in the period before attainment, including regular, consistent reductions sufficient to assure attainment by the required date. (§ 172(b)(3); ¶ 6.)

● Provide for implementation of all reasonably available control measures (RACM) as expeditiously as practicable, insofar as necessary to assure reasonable further progress and attainment by the required date. This includes reasonably available control technology (RACT) for stationary sources and reasonably available transportation control measures. (§§ 172(b)(2), (8); ¶¶ 4–5.)

● Include an accurate, current inventory of emissions that have an impact on the nonattainment area, and provide for annual updates to indicate emissions growth and progress in reducing emissions from existing sources. (§ 172(b)(4); ¶¶ 2, 7–8.)

● Expressly quantify the emissions growth allowance, if any, that will be allowed to result from new major sources or major modifications of existing sources, which may not be so large as to jeopardize reasonable further progress or attainment by the required date. (§§ 172(b)(3) and (5); ¶ 7.)

● Require preconstruction review permits for new major sources and major modifications of existing sources, to be issued in accordance with section 173 of the Act. (§ 172(b)(6); ¶ 9.)

● Include the following additional SIP elements: (§§ 172(b)(7), (9)–(10); ¶¶ 4, 10–11.)[19]

—Identification and commitment of the necessary resources to carry out the Part D provisions of the plan.

—Evidence of public, local government, and state legislative involvement and consultation in accordance with section 174 of the Act.

—Identification and brief analysis of the air quality, health, welfare, economic, energy, and social effects of the plan provisions chosen and the alternatives considered, and a summary of the public comment on the analysis.

—Written evidence that the state and other governmental bodies have adopted the necessary requirements in legally enforceable form.

—Written evidence that the state and other governmental bodies are committed to implement and enforce the appropriate elements of the SIP.

2. *Additional Requirements for Ozone or Carbon Monoxide SIPs with Attainment Dates After 1982:*

● Include an adequate on-going vehicle emission control inspection/maintenance program, or establish a specific schedule endorsed by and committed to by the governor (or the chief executive of the local or regional governmental unit, if it is responsible for implementation) for the development, adoption, and implementation of such a program as expeditiously as practicable. (§ 172(b)(11)(B); ¶ 2.)

● Present a program for selecting a package of transportation control measures (and any other necessary measures) to attain the emission reductions target ascribed in the SIP to the package, including adopted schedules for expeditious implementation of currently planned reasonable transportation control measures, and schedules for analysis and adoption of additional transportation control (and other necessary) measures. (§§ 110(a)(3)(D), 172(b)(2) & (11)(C); Oxidant ¶¶ 1–5.)

● Include a commitment to establish, expand, or improve public transportation measures to meet basic transportation needs as expeditiously as practicable, including a commitment to use necessary federal grants and state and local funds. (§§ 110(a)(3)(D), 172(b)(2); ¶¶ 3–4.)

● Establish a program that requires, before issuance of a preconstruction review permit, an analysis of alternative sites and other factors which demonstrates that the benefits of the proposed source significantly outweigh any environmental and social costs. (§ 172(b)(11)(A); ¶1.)

B. *Further Guidance.*

1. *Need for All RACM.* Part D requires the SIP to provide for that level of control necessary to assure attainment of the standards as expeditiously as practicable, and no later than the specified deadlines, and reasonable further progress in the interim. It does not require that all sources apply RACM if less than all RACM will suffice for reasonable further progress and attainment. Therefore, if a state adopts less than all RACM and demonstrates (a) that reasonable further progress and attainment of the NAAQS are assured, and (b) that application of all RACM would not result in attainment any faster, then a plan with less than all RACM may be approved. An exception is that most ozone SIPs must include, as a minimum, RACT requirements for certain stationary sources (discussed in subsection 3 below, on *Ozone Control Strategy*).

2. *Schedules.* Ordinarily all necessary measures must be adopted in legally enforceable form. However, for certain classes of measures, EPA interprets the Act to allow approval of plans containing schedules for expeditious development, adoption, submittal, and implementation of these measures. Schedules may be used for the following: (a) Measures to control particulate matter sources that EPA has not traditionally treated as causes of NAAQS violations ("nontraditional" sources—for example, sources of urban fugitive dust, resuspended road dust, and dust from construction, as distinguished from fugitive and stack process emissions from stationary sources); (b) RACT requirements for stationary volatile organic compound (VOC) sources for which EPA has not issued a Control Techniques Guideline

[18] *See* citations in note 7 above. For the items in subsection 1 of the text below, the paragraph numbers refer to paragraphs in the section of the Administrator's memorandum entitled "General Requirements of all 1979 SIP Revisions." For items in subsection 2 of the text below, paragraph numbers refer to paragraphs in the section of the memorandum entitled "Additional Requirements for Carbon Monoxide and Oxidant SIP Revisions Which Provide for Attainment of the Primary Standards Later Than 1982," except that paragraph numbers identified by the word "Oxidant" refer to paragraphs in the section of the memorandum entitled "Carbon Monoxide and Oxidant."

[19] These SIP elements are required for all SIP provisions needed to satisfy Part D, except for provisions that were approved or promulgated, and implemented, prior to enactment of the 1977 Amendments (August 7, 1977). The elements required by section 110(a)(2)(F)(i) (that is, assurances of adequate personnel, funding and authority) are needed for all SIP provisions.

Under sections 172(b)(10) and 174 of the Act, the SIP may provide that local governments or regional agencies, rather than the state itself, is responsible for implementing and enforcing particular plan provisions. Where this is done, (1) the plan provisions must still be adopted by the state and submitted to EPA by the Governor, (2) the state must evidence its determination that the local or regional body has legal authority to implement the provision, and (3) the local or regional body must evidence its commitment of necessary resources, adoption of enforceable requirements, and commitment to implement and enforce the plan elements. For some elements, such as inspection/maintenance provisions, item (3) will also require a certification by the local or regional body that it has adopted necessary ordinances or other legislative authorization. *See* the last paragraph of note 27 below, on inspection/maintenance.

by January 1978; (c) inspection/maintenance programs; and (d) transportation control measures.

Schedules must provide for implementation of measures quickly enough to assure that the SIP will provide for reasonable further progress and attainment by the required date. Schedules for control of stationary VOC sources and for inspection/maintenance programs also must meet, at a minimum, the deadlines and other specific requirements for these kinds of measures established in EPA guidance, which are summarized below (in subsections 3 and 4, on *Ozone Control Strategy* and *Inspection/Maintenance).* For controls of nontraditional particulate matter sources and for transportation controls, where analysis, selection, and adoption cannot be completed in time to be approved by July 1, 1979, schedules may provide for expeditious completion of analysis, selection, and adoption. By the applicable deadline in the schedule, the state must adopt the necessary measures in legally enforceable form, along with any necessary additional schedules for expeditious implementation of the measures.

Each schedule must contain key milestones to be used for evaluating progress in completing the scheduled tasks, including as precise a description as possible of what must be accomplished by each key milestone. In order to contribute to the demonstration of reasonable further progress and attainment, each schedule must include a target of how much emission reduction will result, and when, from each measure or group of related measures.

Each schedule must be adopted as part of the SIP, and each state or other governmental body responsible for implementation must be committed to meet the key milestones.[20] The state and other governmental bodies must therefore be committed to analyze, select, adopt, and implement measures necessary to achieve the emission reductions ascribed to the schedules. There is a partial exception for ozone and carbon monoxide measures that are not reasonably available for implementation before the end of 1982: The state and other governmental bodies must be committed to meeting the key milestones for analyzing and selecting such measures for the post-1982 period, but need not submit the adopted enforceable measures, and schedules and commitments to implement them, until, at the latest, July 1, 1982.[21]

3. *Ozone Control Strategy.* Although an ozone SIP must assure reasonable further progress and attainment in all nonattainment areas, the SIP need not include a specific demonstration of reasonable further progress and attainment in rural areas. (A designated nonattainment area may consist of one or more "urbanized areas" surrounded by "rural areas.")[22] Such a demonstration in all urbanized areas, along with at least the minimum stationary-source requirements described below, should assure reasonable further progress and attainment in the rural areas by minimizing the pollutants transported from urbanized to rural areas.

Because it is often difficult to develop precise ozone control strategies, and because sections 172(a)(2) and (b)(3) require minimum levels of control technology, the minimum acceptable level of stationary source control for ozone SIPs is the following: Ozone SIPs being revised now must include adopted RACT requirements for VOC sources covered by Control Techniques Guidelines (CTGs) that EPA issued by January 1978, and schedules to adopt and submit by each future January additional requirements for the sources covered by CTGs issued by the previous January. For SIPs with attainment dates after 1982, these RACT requirements must apply in urbanized areas to all sources covered by each CTG, and in rural areas to all "major" sources (that is, over 100 tons/year potential emissions)[23] covered by each CTG. (Such SIPs must also provide for the control of additional sources where necessary to achieve reasonable further progress, as discussed below.) For SIPs with attainment dates before the end of 1982 that do not use photochemical dispersion modeling, these RACT requirements must apply to all major sources covered by each CTG, and in urbanized areas to enough additional sources covered by each CTG to provide for reasonable further progress and attainment as expeditiously as practicable. In SIPs with attainment dates before the end of 1982 that do use photochemical dispersion modeling, these RACT requirements must apply to enough sources covered by each CTG to provide for reasonable further progress and attainment as expeditiously as practicable.[24]

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[20] Failure to meet a key milestone to which the state or other governmental body is committed may be treated as a failure to "implement" and "carry out" the SIP under sections 173(4), 176(b), and 316(b)(2) of the Act, and under some circumstances may be treated as a "violation" of a requirement of the SIP under section 113(a)(1). Furthermore, certain milestones in each schedule will be deadlines for submitting additional necessary elements of the SIP, such as certification of adequate legal authority, evidence that the necessary requirements have been adopted in legally enforceable form, or evidence that the state or local government is committed to implement and enforce the appropriate plan elements. Regardless of whether the state or other governmental body is committed to meeting these milestones for submitting additional elements, failure to meet them may render the SIP no longer adequate to satisfy the requirements of Part D under section 110(a)(2)(I) of the Act, and in some circumstances may be treated as a failure to submit a plan that considers an element required by Part D under section 176(a) of the Act.

[21] Section 172(c) of the Act establishes a July 1, 1982 deadline for the SIP to contain all enforceable measures necessary for attainment by the end of 1987. The July 1, 1982 deadline applies only to measures not reasonably available earlier. The state may not delay adoption and implementation of measures that are reasonably available earlier on account of section 172(c). *See* Clean Air Amendments of 1977, Conference Report to accompany H.R. 6161, H.R. Rep. No. 95-564, 95th Cong., 1st Sess. 157 (August 3, 1977).

[22] For purposes of ozone plan development, "urbanized area" means a central city and surrounding closely settled areas with population of 200,00 or more, according to the 1970 Census, plus any adjacent fringe areas of development. Any other area is a "rural area."

Since reasonable further progress and attainment need not be demonstrated in a rural area, ozone SIPs that satisfy all Part D requirements under EPA guidance for a rural area and for the urbanized areas that cause the nonattainment problem in the rural area will provide an inherent emissions growth allowance for new major sources in the rural area. This means that a permit may be issued for major sources of VOC in such rural areas, under section 173 of the Act, without a specific demonstration that the new emissions will be accommodated under section 173(l) (*See* discussion in subsection 10.a below, on *Preconstruction Review.*) If extensive growth changes the demographic character of an area from rural to urbanized, a demonstration of reasonable further progress and attainment may then be called for in the newly urbanized area.

[23] "Potential" to emit means the maximum capacity to emit a pollutant absent air pollution control equipment. *See* sections II.A.1 through 5 of the Offset Ruling, note 3 above.

[24] The above sets forth the minimum level of stationary source control that must be included not only in the SIP, but also in the demonstration that attainment is impossible by the end of 1982 despite implementation of all reasonably available measures, which is necessary under section 172(a)(2) to qualify for an attainment date after the end of 1982.

Linear rollback techniques for determining needed emission reductions are acceptable for use in 1979 SIP submittals. Plans with attainment dates after 1982, however, must be revised by July 1, 1982 to use more rigorous techniques.

[25] That is, the SIP must do the following to the extent necessary to achieve straight-line reductions at the end of 1982: (1) Include *all* RACT, including RACT for source categories in addition to those that will be covered by EPA's CTG series, and, for source categories that will be covered by CTGs, adopt RACT requirements sooner than would be required by EPA's CTG program described in the text above; (2) provide for especially expeditious and ambitious reasonably available transportation control measures; and (3) permit new major sources and major modifications only with case-by-case offsetting emission reductions (*see* discussion on *Preconstruction Review* in subsection 10 below of the text). As a practical matter, a SIP that requires application of all RACT and includes no emissions growth allowance for new major sources should assure straight-line reductions at the end of 1982 for even the most seriously polluted area.

An ozone plan with an attainment date after 1982 will satisfy the requirement for reasonable further progress if the SIP requires at least (1) "straight-line reductions" at the end of 1982, or (2) reductions that reflect application of all RACM as expeditiously as practicable through the end of 1982 with no emissions growth allowance for new major sources.[25] "Straight-line reductions" mean reductions at the end of 1982 at least as great as if equal annual reductions were required between 1979 and the attainment date, which can be represented graphically by a straight line. Until the end of 1982, allowable emissions may remain above the straight line to accommodate the time required for compliance.

4. *Inspection/Maintenance.* An acceptable inspection/maintenance program or schedule is required in urbanized areas for every ozone or carbon monoxide SIP with an attainment date after 1982.[26] In addition, for SIPs with attainment dates by the end of 1982, states may find that inspection/maintenance is helpful to assure reasonable further progress and attainment by the required date, or even to provide an emissions growth allowance for new major sources. For urbanized areas with attainment dates after 1982, the SIP must contain a commitment of the state, local government, or regional agency to implement the program as expeditiously as practicable. EPA has determined that the final deadline for submitting assurances of adequate legal authority to carry out the program is June 30, 1979, with limited exceptions.[27] Final implementation of the program (including adoption and submission to EPA of all necessary requirements for mandatory inspection and repair of failed vehicles) must be scheduled for no later than the end of 1982 for a centralized program, or the end of 1981 for a decentralized program.[28] Failure to submit by the required deadlines the legal authority and all regulatory requirements necessary for mandatory inspection and mandatory repair of failed vehicles will make the SIP no longer adequate to satisfy the requirements of Part D.

5. *Transportation Control Measures.* For urbanized areas, each SIP with an attainment date after 1982 must contain schedules for implementation of currently planned reasonably available transportation control measures, and schedules for analysis, selection and adoption of additional transportation control measures, sufficient to achieve the emission reductions target ascribed to transportation control in the demonstration of reasonable further progress and attainment. As noted above, by the applicable deadlines in the schedules, the state must adopt the necessary measures, along with any necessary additional schedules and commitments for expeditious implementation of the measures. It is EPA's policy that each area will be required to schedule a representative selection of reasonable transportation control measures for implementation at least on a pilot or demonstration basis before the end of 1980.

The determination of what transportation control measures are reasonably available must be made on a case-by-case basis. The measures listed in section 108(f)(1)(A) of the Act are presumed to be reasonably available. If a state or local government believes that in its particular situation any of the measures listed (except inspection/maintenance) is not reasonably available, the burden is on the state or local government to demonstrate the unavailability of the measure, based on the local situation. A demonstration that a measure is not reasonably available must be based on substantial widespread and long-term adverse impact that would result from the measure, and on the time needed to analyze, develop and implement the measure. These factors bear both on whether a measure is reasonable and on whether a schedule calls for implementation as expeditiously as practicable.

6. *Ozone Standard.* EPA recently changed the required level under the primary and secondary NAAQS for ozone from 0.08 to 0.12 parts per million (and changed the designation of the NAAQS from "photochemical oxidants" to "ozone").[29] A SIP is now acceptable if it meets all Part D requirements for the NAAQS at a level of 0.12 or below. A state may, if it wishes, relax new requirements in a 1979 SIP submittal designed for a level below 0.12, so long

[25] That is, the SIP must do the following to the extent necessary to achieve straight-line reductions at the end of 1982: (1) Include *all* RACT, including RACT for source categories in addition to those that will be covered by EPA's CTG series, and, for source categories that will be covered by CTGs, adopt RACT requirements sooner than would be required by EPA's CTG program described in the text above; (2) provide for especially expeditious and ambitious reasonably available transportation control measures; and (3) permit new major sources and major modifications only with case-by-case offsetting emission reductions (*see* discussion on *Preconstruction Review* in subsection 10 below of the text). As a practical matter, a SIP that requires application of all RACT and includes no emissions growth allowance for new major sources should assure straight-line reductions at the end of 1982 for even the most seriously polluted area.

[26] "Urbanized area" is defined in note 22 above. Statewide programs are encouraged, especially for states that are small and highly urbanized. EPA will review the need for inspection/maintenance in non-urbanized areas after the 1979 SIP revisions are submitted and will consider additional requirements at that time. For some carbon monoxide SIPs, regardless of whether attainment will be after 1982, inspection/maintenance for non/urbanized areas may now be necessary to demonstrate reasonable further progress and attainment.

[27] Limited exceptions to the June 30, 1979 deadline for supplying certification of adequate legal authority may be possible if the state (or other governmental body) can demonstrate that the legislature has had no opportunity to consider any necessary enabling legislation between enactment of the 1977 Amendments (August 7, 1977) and June 30, 1979. Extension beyond June 30, 1979 is an exceptional remedy, and EPA will grant no extension if the legislature has had an opportunity to consider enabling legislation but has not given such legislation serious consideration. (EPA had also contemplated extensions for situations where there had been insufficient opportunity to conduct necessary technical analyses; however, as far as EPA is aware, the needed information is now available.) In no case may the assurances of adequate legal authority be supplied later than July 1, 1980. Where legislative action will occur after the SIP has been approved, submittal of assurances of adquate legal authority must be included as a key milestone in the schedule for implementation of the program.

Legal authority by the required deadline is necessary to satisfy the requirements of sections 172(b)(7) and (10) of the Act, which call for evidence that the state or other governmental body has legally adopted the necessary requirements and schedules and timetables for compliance, is committed to implement and enforce the elements of the SIP, and has committed the necessary resources to carry out the SIP. If legal authority is provided but is later withdrawn or found to be inadequate to authorize implementation of the required program, the SIP will then no longer satisfy the requirements of section 172(b)(7) and (10).

See note 19 above, on commitments by governmental bodies other than the state. Where a local or regional body will implement the program, the deadline for certification that such a body has necessary legal authority is the same as for a state—that is, June 30, 1979, with limited exceptions.

[28] A "centralized" program is one where inspection testing is conducted at facilities owned and operated by a state, local, or regional governmental agency, or a contractor working for the agency. A "decentralized" program is one where testing is conducted at private garages licensed to conduct the tests by the state, local, or regional agency. The deadlines for implementation apply regardless of when authorizing legislation is obtained. The Administrator's memorandum on criteria for approval (note 7 above) had provided that the deadline for implementation would be earlier for areas that obtain legislation earlier. However, the Agency has modified this policy. EPA believes that the uniform deadlines stated in the text, for obtaining legislative authority and for implementing the necessary programs, will foster equity among states and coordination in administering programs in interstate metropolitan areas, and that compliance with the deadlines will constitute implementation of the programs as expeditiously as practicable. *See also* note 21 above, explaining that the July 1, 1982 deadline under section 172(c) of the Act is irrelevant to inspection/maintenance legislation, which is now reasonably available.

[29] 40 CFR 50.9, as revised 44 FR 8220 (February 8, 1979).

as the revised SIP meets all requirements for the 0.12 level.

Being a relaxation, the revision to the ozone standard does not affect the schedule for submittal of SIP revisions required under Part D. Section 110(a)(1) of the Act requires that SIP revisions be submitted within 9 months after a standard is revised. This refers only to SIP revisions legally required because of the revision to the standard. However, where a standard is relaxed, no SIP revision is required by law, since states may have more stringent controls than necessary if they choose.[30] It is optional with the state whether to relax new requirements back to the 0.12 level, and the state may therefore determine its own schedule for accomplishing this.

The relaxation of the ozone NAAQS may allow some areas now designated nonattainment to have their designations changed, under section 107(d)(5) of the Act. In order to clear up any questions about what is a nonattainment area before the July 1, 1979 deadline for having approved Part D SIPs,[31] states are urged to promptly submit lists of areas that may be redesignated, along with supporting documentation. EPA will then promulgate the revised lists as soon as possible, with any necessary modifications.

7. *Interstate and International Issues.* Pollutants entering a state from sources in neighboring states, countries, or bodies of water, and contributing to the violation of a NAAQS in a nonattainment area, must be included in the demonstration of reasonable further progress and attainment. For purposes of SIP development (although not for purposes of making nonattainment designations under section 107(d) of the Act), states may assume that the NAAQS will be attained by the appropriate deadlines under the Act in neighboring states, countries, and bodies of water, and that all SIP requirements in neighboring states will be met. For interstate (and intrastate) urbanized areas that are nonattainment for ozone, the highest pollutant concentration for the entire area must be used in determining the necessary level of control.

8. *Secondary Standards.* Particulate matter and sulfur oxides are the only pollutants for which secondary NAAQS are more stringent than primary NAAQS. These secondary standards must be attained as expeditiously as practicable, but no later than the end of 1982 where application of all RACT by the end of 1982 will result in attainment.[32] Where application of all RACT will not be sufficient, or where the state shows that good cause exists for postponing its application, then an attainment date later than 1982 may be provided for in the SIP. This date must be as expeditious as practicable considering the amount of emission reductions needed and the problems involved in obtaining them.

The January 1, 1979 deadline for deadline for submittal of the SIP revision and the July 1, 1979 deadline for its approval may be extended up to 18-months for a secondary NAAQS.[33] The state must request an extension, and include a showing that attainment will require emission reductions greater than those that would result from application of all RACT.

9. *Fugitive Dust.* "Rural areas" (as defined according to EPA's Fugitive Dust Policy)[34] experiencing particulate matter violations that can be attributed to fugitive dust (that is, native airborne soil uncontaminated by man-made sources) can under certain conditions be designated as attaining the NAAQS. Areas so designated do not need SIPs that satisfy the requirements of Part D. Non-rural areas that experience particulate matter violations, even if attributed to airborne soil, must be designated as non-attainment and must have SIPs that satisfy the requirements of Part D. "Rural"areas are defined for these purposes as those that have (1) a lack of major industrial development or the absence of significant industrial particulate emissions, and (2) low urbanized population. All other areas are "non-rural" areas.

Where fugitive dust in non-rural areas causes or contributes to particulate matter violations SIPs must include sufficient controls to demonstrate reasonable further progress and attainment of the standard by the required date. SIPs for non-rural urban areas must contain adopted RACT requirements for traditional sources and either adopted requirements or schedules for study and subsequent adoption of requirements for nontraditional sources. *(See* subsection 2 above, on *Schedules.)* Controls of fugitive dust sources in non-rural areas must be included, if controls to be applied to other sources are not sufficient to demonstrate reasonable further progress and attainment.

10. *Preconstruction Review.*

a. *Basic Statutory Requirements.* To satisfy the requirements of Part D,[35] a preconstruction review program must assure that permits for proposed major sources and major modifications may be issued only if the following conditions of sections 172(b)(11)(A) and 173 of the Act are satisfied:

i. *Requirements for all Part D SIPs:*

● The proposed major source or major modification is accommodated by one or both of the following approaches:

(A) There are sufficient case-by-case offsetting emission reductions (offsets) and other emission reductions required under the SIP, so that allowable emissions from all sources when the proposed major source or major modification is to commence operation represent reasonable further progress, or

(B) Emissions resulting from the proposed major source or major modification are accommodated by the emissions growth allowance for major new sources.

● Any emission reductions required under paragraph (A) must be legally binding and enforceable before the permit may be issued. (§ 173(1) and the sentence of § 173 after subsection (4).)

● The proposed major source or major modification must comply with the lowest achievable emission rate (LAER), as that term is defined in section 171(3) of the Act. (§ 173(2).)

● All major sources in the state owned or operated by the owner or operator of the proposed major source or major modification must be in compliance (or on a schedule for compliance) with the Act. (§ 173(3).)

ii. *Additional requirements for ozone and carbon monoxide SIPs with attainment dates after 1982:*

● An analysis must have been conducted of alternative sites, sizes, production processes, and environmental control techniques for the proposed major source or major

[30] An adequate SIP designed for an ozone level below 0.12 will be at least stringent enough to satisfy requirements for the 0.12 level, as required by July 1, 1979.

[31] The revised standard is immediately effective for determining whether a proposed new source would cause or contribute to a violation of the standard, for purposes of preconstruction review, regardless of the designations. However, the requirement to have a revised SIP that satisfies Part D remains in effect for all nonattainment areas until EPA promulgates a different designation. *See* the discussion in subsection 11 of the text below, on *Changes in Designation.*

[32] *See* 40 CFR 51.13(b).

[33] *See* section 110(b) of the Act; 40 CFR 51.31.

[34] *See* memorandum from Edward F. Tuerk, EPA acting Assistant Administrator for Air & Waste Management, to EPA Regional Administrators, on "Guidance on SIP Development and New Source Review in Areas Impacted by Fugitive Dust" (August 16, 1977), and the attachment entitled *Fugitive Dust Policy: SIP's and New Source Review* (August 1, 1977); Preamble to initial designations of attainment status, 43 FR 8963 col. 1, (March 3, 1978); section II.A.8 of the Offset Ruling, note 3 above.

[35] There are several other preconstruction review requirements under the Act that are not Part D requirements. *E.g.*, section 110(a)(2)(D) of the Act and section II.B of the Offset Ruling, note 3 above.

modification which demonstrates that benefits significantly outweigh any environmental and social costs. (§ 172(b)(11)(A).)

The submitted preconstruction review program must be legally enforceable, and may satisfy the requirements of Part D by referring to these requirements of the Act and stating that permits will be issued only in compliance with them, or by restating these requirements (or requirements more stringent).

Aside from the specific requirements discussed above, a state preconstruction review program along with other SIP provisions must impose enough controls on new and existing sources that resonable further progress and attainment will actually occur as required. If this does not happen, major source and major modifications may be unable to obtain permits in the future, existing sources may have to apply even more stringent controls, and the overall SIP may be found not to satisfy Part D requirements. The state preconstruction review program must therefore be adequate, considering the particular circumstances of the overall SIP and the area to which it applies, to assure reasonable further progress and attainment.

b. *Requirements From the Emission Offset Interpretative Ruling.* EPA's recently revised Emission Offset Interpretative Ruling now governs preconstruction review of any major source or major modification that would cause or contribute to a violation of a NAAQS. Under the statute, the Ruling is to be superseded for nonattainment areas after June 30, 1979, by preconstruction review provisions of the revised SIP, if the SIP meets the requirements of Part D. If the SIP does not meet the requirements of Part D, the Ruling is to be superseded by a prohibition on major source construction under the applicable SIP and section 110(a)(2)(I) of the Act (discussed below in subsection f, on *Prohibition on New Construction*. The Ruling will remain in effect to the extent not superseded under the Act. [36]

The revised Ruling and accompanying **Federal Register** preamble set forth EPA's views on several issues that are relevant under Part D. Many of the approaches used by the Agency in revising the Ruling may be used by the states as guidance in developing provisions under Part D. But to establish uniform minimum requirements and consistent statutory definitions, EPA requires that state programs apply certain fundamental policies that EPA adopted in revising the Ruling (or be more stringent): [37]

- The SIP must require permits for the construction and operation of all proposed "major sources" and "major modifications," with those terms given definitions equivalent to those in the Ruling. (Ruling §§ II.A.1 through 5.)
- Permits may be issued without satisfying the requirements under sections 172(b)(11)(A) and 173(1), (2) and (3) of the Act, for proposed major sources and major modifications that do not have allowable emissions exceeding 50 tons per year, 1000 pounds per day, or 100 pounds per hour, whichever is most restrictive. (Ruling § II.C.)
- Permits may be issued without satisfying the requirements under sections 172(b)(11)(A) and 173(1), (2) and (3) of the Act, for proposed major modifications of existing facilities (that is, modifications of identifiable pieces of process equipment) with accompanying offsets within the same source (intra-source offsets) such that there is no net increase in allowable emissions. (As explained in the preamble to the revised Ruling, this requirement is more lenient than that found in the Ruling itself. 44 FR at 3276–3277.)
- In determining the lowest achievable emission rate (LAER), the reviewing authority may consider transfer of technology from one source type to another where such technology is applicable. (44 FR at 3280–3281.)

If a state adopts a regulation in the SIP that is not inconsistent with these mandatory policies, EPA proposes to assume that the state intends to implement its preconstruction review program in accordance with these policies. EPA proposes to conduct its enforcement activities accordingly. Alternatively, the state may adopt regulations that expressly incorporate these mandatory policies (or approaches more stringent).

c. *Geographic Applicability.* At a minimum, the program must apply to any major source [38] in the state that would cause or contribute to a violation of the NAAQS within the designated nonattainment area. [39] The Ruling establishes certain exemptions for a source locating at a site where the NAAQS is not actually violated. Although sections 172(b)(11)(A) and 173 do not expressly allow exemptions from a preconstruction review program, EPA interprets the Act to allow exemptions like those in the Ruling. A state may therefore make the following provision for major sources locating at sites where the NAAQS is not violated (as of the new source start-up date):

- A source whose allowable emissions would not cause or significantly contribute a violation of the NAAQS may be exempted from all requirements under sections 172(b)(11)(A) and 173(1), (2), and (3). (Ruling §§ II.D and E.)
- A source that would cause a new violation of the NAAQS may be exempted from all requirements under sections 172(b)(11)(A) and 173(1), (2), and (3), except that it must have sufficient offsets so that allowable emissions from the new source and existing sources will not, in fact, cause a violation. (Ruling § III.)
- For a source that would contribute significantly to an existing violation, emissions that result from the source must be accommodated under section 173(1) only to the extent that those emissions would actually contribute to the violation. All other applicable requirements (including the requirement under section 173(1)(A) to accommodate certain emissions that do not result from the source) must be satisfied in full. (Ruling §§ II. D and E.)

d. *Exempted Types of Sources.* In addition to the exemptions discussed above involving location of a source, the revised Ruling provides that certain types of major sources may be exempted from the requirement for offsets. In adopting its preconstruction review program, the state may exempt similar types of sources from the requirement of section 173(1) that emissions be accommodated by offsets or by the emission growth allowance, as long as the exemptions established by the state cover classes of sources no

[36] *See* section 129(a)(1) of the 1977 Amendments (note under 42 U.S.C. 7502); section I of the Offset Ruling, note 3 above. The Ruling is therefore to apply after July 1, 1979, in the following situations: (a) To proposed major sources in one state that would contribute to a violation of a NAAQS only in another state, (b) during the time allowed for the development and approval of a revised SIP in an area that is designated as nonattainment after March 3, 1978, and (c) during any extended time allowed under secton 110(B) for development of a SIP revision for an area that violates the secondary NAAQS but not the primary NAAQS for a pollutant. Furthermore, the Ruling applies everwhere in the state, regardless of the applicable designation under section 107(d) of the Act. *See* sections II.D and E of the Ruling. For any areas in the state where neither a Part D preconstruction review program nor a section 110(a)(2)(I) prohibition on issuance of permits applies, the Ruling will not be superseded and will continue to apply to every source that would cause or contribute to a NAAQS violation.

[37] *See* the preamble to the revised Ruling, 44 FR 3276 col. 1. (January 16, 1979). EPA considered comment received before publication of the revised Ruling, and the Agency invited additional comment. As soon as EPA has completed reviewing and responding to these latter comments, it will publish a response.

[38] Except where the context indicates otherwise, reference to any "major source" includes any major modification.

[39] *See* the preamble to the revised Ruling, 44 FR 3275 col. 3 (January 16, 1979).

broader than those exempted under the Ruling. The types of sources exempted under the Ruling are: (i) Resource recovery facilities burning municipal solid wast, (ii) sources that must switch fuels due to lack of adequate fule supplies or where a source is required to be modified as a result of EPA regulations and no exemption from such regulation is available to the source, (iii) temporary emission sources, and (iv) emissions resulting from the construction phase of a new source. (Ruling § IV.B.)

As under the Ruling, exemptions for resource recovery facilities and sources that must switch fuels may be permitted only if (A) the new emissions are charged against the emissions growth increment for major new sources to the extent there is any, (B) the applicant demonstrates that it made its best efforts to obtain sufficient offsets, (C) the applicant applies all offsets that are available, and (D) the applicant will continue to seek the necessary offsets and apply them when they become available. Issuance of a permit under an exemption for resource recovery facilities or sources that must switch fuels will ordinarily cause the inventory of allowable emissions to exceed what is permitted; for reasonable further progress. Therefore, no further permits for major sources may be issued under section 173(1) until the deficit is made up by either additional offsets or a SIP revision, to provide additional control of existing sources.

e. *Banking.* Under the policy expressed in the Offset Ruling (§ IV.C.5), the state may allow emission reductions to be banked for later use under the Ruling and under the state's preconstruction review program under Part D. The SIP should provide procedures for managing banked emission reductions, such as SIP revisions or permit conditions. Banked emission reductions may be used for case-by-case offsets under section 173(1)(A), by contributing part or all of the required offsetting reductions in allowable emissions. To be sufficient under that section, the offsetting reductions in allowable emissions, including any banked emission reductions being used, must be sufficient to represent reasonable further progress. Alternatively, banked emission reductions may be preserved for use under section 173(1)(B), by being added to the emissions growth allowance for new major sources. Adding to the allowance requires a SIP revision, and will be approved by EPA only if the enlarged allowance will not interfere with reasonable further progress and attainment by the required date.

f. *Prohibition on New Construction.* Sections 110(a)(2)(I), 113(a)(5), and 173(4) of the Act and section I of the Ruling provide that new major sources and major modifications that would cause or contribute to a NAAQS violation within the nonattainment area are not to be constructed if either of the following circumstances applies:

i. If there is a period after June 30, 1979 when a SIP does not satisfy the requirements of Part D, no major source or major modification is to be constructed under a permit applied for during that period, until after the approved SIP meets Part D requirements. If the permit was applied for before July 1, 1979, or before the period when the SIP fails to satisfy Part D requirements, construction is not restricted by any failure of the SIP to satisfy Part D requirements (as long as requirements of the Ruling or of an adequate Part D preconstruction review program, whichever is applicable, are satisfied).

ii. If there is a period after June 30, 1979 when a SIP is not being carried out in accordance with the requirements of Part D, no permits are to be issued until the SIP is carried out in accordance with those requirements. To the extent that the state does not carry out these prohibitions against new construction under sections 110(a)(2)(I), 113(a)(5), and 173(4), the Act provides for EPA to do so.

11. *Changes in Designation.* In developing a Part D SIP revision for a designated nonattainment area, the state may determine that the designation is inappropriate. If this occurs, the state may submit to EPA a revised designation with supporting material. Until EPA finds the revised designation acceptable and promulgates it, the July 1 deadline for approval of a SIP revision satisfying Part D will continue to apply. However, the SIP submittal may simply demonstrate that the standard is attained and that no additional emission reductions or preconstruction review requirements need to be included in the SIP.[40]

The July 1 deadline applies only for areas designated as nonattainment in the initial March 3, 1978 promulgation.[41] For any area designated as nonattainment after March 3, 1978, the state will have nine months after the new designation is promulgated to submit a SIP revision satisfying the requirements of Part D. No additional time is available, however, when an area boundary is adjusted but the same air quality problem and sources contributing to the problem are addressed.

IV. Approval of Revised SIP as Satisfying Non-Part D Requirements

The final question that EPA must determine in reviewing a SIP submittal is whether the revised applicable implementation plan satisfies all requirements in the Act that are not Part D requirements. A state's failure to satisfy non-Part D requirements creates an obligation under Section 110(c) of the Act for EPA to promulgate substitute SIP provisions to satisfy those requirements, but does not require withholding of new source permits and highway and air pollution control program grants.[42]

Many states are submitting SIP provisions to satisfy non-Part D requirements along with their Part D submittals. EPA must review these submittals as soon as possible to determine whether they should be approved, and must review all applicable implementation plans as soon as possible to determine what non-Part D requirements remain unsatisfied. In some cases EPA will consider non-Part D submittals along with Part D submittals, and in other cases EPA will defer consideration of non-Part D submittals until later. The Federal Register proposals referring to individual state plans will identify any non-Part D decisions to be made and the relevant considerations.

(Secs. 110(a), 172, Clean Air Act, as amended (42 U.S.C. 7410(a), 7502))

Dated: March 23, 1979.

David G. Hawkins,

Assistant Administrator for Air, Noise and Radiation.

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[40] For purposes of preconstruction review, the determination of whether a proposed new source would cause or contribute to a violation of the standard may be made without regard to the applicable designation. *See* subsections 10.c and f of the text above, in the discussion on *Preconstruction Review;* discussion on EFFECT OF DESIGNATIONS ON CLEAN AIR ACT REQUIREMENTS in the general preamble on revised designations of attainment status, 43 FR 40412-13 (September 11, 1978).

[41] *See* note 6 above.

[42] Several SIP revisions are required by the 1977 Amendments to the Act but are not Part D requirements. These include the requirements of sections 128 (state boards), 110(a)(2)(E) and 126 (interstate pollution), 127 (public notification), 160 *et seq.* (PSD), 110 (a)(2)(K) (permit fees), 123 (stack heights in other than nonattainment areas), 121 (consultation), and 110(a)(6) (pay reduction).